

## Level of business development is not sufficient for successful competition

The Global Competitiveness Report 2013 suggests that Ukraine's economy is insufficiently competitive on a global scale. Last year, the Ukrainian National Competitiveness Report highlighted the country's largest concern as institutions, focusing on the efficiency of public institutions. Not everything depends on the government and its economic intervention – the role and responsibility of the business should not be underestimated. Corruption is triggered by tacit consent of businesses' to work with underhand schemes; the workforce is not highly skilled as the companies are reluctant to invest in employee development, and the market competitiveness is not perfect as not all players seek a fair and open play. There are barriers in raising external capital, because business reporting standards and transparency are not ideal, advanced technologies are not widely spread since businesses are very often not prepared to adopt them both from perspective of their mindset and technology, etc.

Report 2013 looks into the soft and hard factors which drive business sophistication in a move to see how committed and capable businesses are in their contribution to the country's competitiveness growth.

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SOFT FACTORS INCLUDE THOSE WHICH ARE PRIMARILY BASED ON ENGAGEMENT WITH PEOPLE AND COMMUNITIES, WHILST HARD FACTORS ARE, FIRST OF ALL, FOCUSED ON THE USE OF TECHNOLOGIES

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Below are the factors which drive business sophistication and can be compared against indicators of the Global Competitiveness Index; business adaptability and corporate governance, corporate ethics, corporate social responsibility and HR policies, innovations and business processes, and corporate finance.

Division of the factors that shape the country's competitiveness via the government-driven and business-driven is quite reasonable. Firstly, this is a typical division into macro and micro levels in the economy. Moreover WEF's Global Risks Report 2013 concludes this is particularly important now as the global economy has not fully recovered, and the situation will remain *fragile* in the near future. Lloyd's Risk Index 2013 also divides the key risks of the global economy into two levels: regulatory risks (high taxation and excessively strict legislation) and economic risks (loss of customers, cost and availability of credit and price of material inputs).

Such approach is vitally important for Ukraine where the economy started to cool down and move to the risk zone in 2012-2013. Emerging Markets Opportunity Index 2012 put Ukraine only at 25th position out of 27. Calculated by Grant Thornton, the index is based on the size and growth forecasts of the economies. The Failed States Index 2012 by The Fund for Peace categorized Ukraine as "warning", ranking it 113th among 177 nations. The index is guided by social, economic and political indicators. In 2013, the world's leading rating agencies, Fitch, Moody's and S&P, have downgraded the country's outlooks and ratings. Finally, current country risk classification, assigned by the OECD, has remained critical for Ukraine in 2013 (score of 7, the same as during the crisis years of the late 1990's and 2000's).

This Report deeply explores business sophistication factors to realize the degree to which Ukraine is ready to face current challenges and risks, notably at the level of businesses, which also determines its ability to face them without any special support from the government. The survey has shown that domestic business is underdeveloped to compete successfully in the global economy. In some cases, the performance of Oblasts and industries corresponds to the bottom positions in the global ranking, while it lags behind key peers in most cases.

FOR THE PURPOSE OF THIS REPORT, PEERS ARE FORMER REPUBLICS OF THE USSR, POST-SOCIALIST NATIONS AND SOMETIMES EMERGING MARKETS COMPARABLE WITH UKRAINE IN TERMS OF THEIR SIZE AND OTHER PARAMETERS, FOR EXAMPLE, TURKEY

In addition, GCI 2013-2014 and Ukrainian National Competitiveness Report 2013 show a downward trend in many indicators of business sophistication factors in the country. We will elaborate on the issue below.

## 3.1 Adaptability

### UKRAINIAN BUSINESSES HAVE LOW ADAPTABILITY CAPACITIES

How prepared are the Ukrainian economy and business to face global and country-specific risks? Risk Management Effectiveness ranking is based on the Global Risks Perception Survey conducted in fall 2012 by the World Economic Forum among respondents of the GCI's Executive Opinion Survey. Ukraine is amongst the worst performers, ranking 119th out of 139 nations.

(4.18), insurance (4.54) and banking (5.01). Small and big businesses earn approximately the same average scores (4.07 and 4.08 respectively), while medium-sized companies perform slightly worse (3.97).

Technological readiness and adaptability help to evaluate risk preparedness of the economy (Figure 3.1).

Changes over the past years show a significant increase in Ukraine's scores for technological readiness indicators. In two of them, the country climbed up nearly 20 places in the global ranking, but in 2013 the country has fallen in the ranks again achieving its lowest position for several years.

Production process sophistication has seen the largest drop: scores in 2013 are approximately the same as in 2009-12 yet the country has lost nearly 10 spots in the GCI. After the global crisis, many countries adopted the latest technologies much more extensively, a fact proven by other indices. In the Globalization Index 2012 (by EY) Ukraine ranks 47th by the degree of globalization (out of 60 economies, with Turkey at 46th and Russia at 48th). Technology is the country's weakest pillar. Its score of 2.2 points is nearly 4 times smaller than the score gained by the ranking's leader, Hong Kong. The technology's aggregated score across the countries has increased approximately 1 score over the decade, with the growth projection for 4 years being another 0.5 points. Knowledge Economy Index 2012 developed by the World Bank places Ukraine at 56th position (Russia at 55th), which is 2 places down from Ukraine's performance in 2000.

Although Ukraine still matches the peers, the technology gap from the top-performing economies is increasing. Moreover, technological readiness varies by Oblast in Ukraine – the country has a noticeable technology gap between oblasts.

Figure 3.2 indicates the gap in the availability of the latest technologies and firm-level technology absorption is about 1 score between the Oblasts. In international comparison, this represents a gap of 35 nations and 55 nations in the GCI respectively. Ukraine's worst performers in the availability of the latest technologies would take the very bottom place in the global ranking, whilst the outsiders in the technology absorption would feature in the bottom 10 of the GCI. Even the country's top performers would rank in the bottom half of the global list.

Availability of the latest technologies by sector receives the lowest assessment from representatives of the

Rank	Country	Score
57	Poland	3.87
73	Russia	3.60
98	Slovak Republic	3.11
103	Hungary	3.03
113	Moldova	2.93
<b>119</b>	<b>Ukraine</b>	<b>2.65</b>
123	Romania	2.53

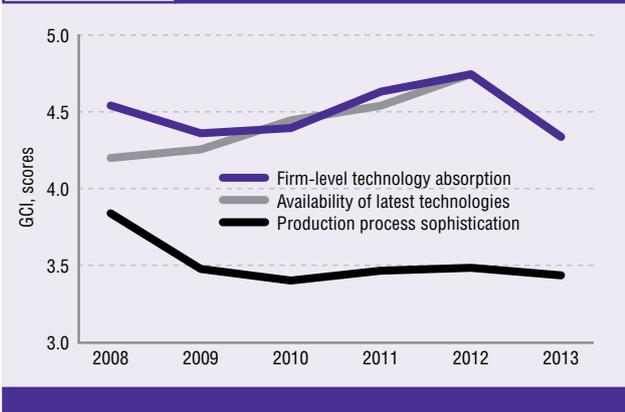
Source: World Economic Forum, Global Risks, 2013.

Similarly, Ukraine scores low (2.54) in “resilience”, which defines the ability of a country to adapt and recover from global risks (Poland and Russia gain 2.86 and 2.84 respectively).

Executive Opinion Survey 2013 conducted by the Foundation for Effective Governance according to the WEF's methodology reveals that business adaptability is explored in the question “How do you assess the ability of your organization to adapt to external shocks (crises, etc.)?” The responses manifest the spread on aggregated score by Oblasts of almost one point (on a 7-point grading scale), which is big by global standards. It is hard to correlate the findings with the overall competitiveness index. For example, Rivne (4.60), Zakarpattia (4.45) and Kharkiv (4.38) appear to be the leaders in business adaptability, while Poltava (3.75), Donetsk (3.70) and Sumy (3.68) are among outsiders.

The Survey finds that business adaptability is lower in resource-based industries: mining (3.55), construction (3.76), electricity, gas and water production (3.87) as well as agriculture (3.90). Services sectors however perform highly in adaptability: trade (4.13), hotels and restaurants

**Figure 3.1** Changes in particular metrics of Ukraine's technological readiness and business sophistication in the GCI



Source: World Economic Forum, *The Global Competitiveness Report, 2008-2013*.

industry – electricity, gas and water companies (3.42), manufacturing (3.45) and mining industry (3.64) – as well as trade (3.52), transport and communications (3.63). Investment and insurance companies as well as hotels and restaurants receive the highest scores: 4.60, 4.02 and 4.14 respectively.

Executives in the industries – mining (3.97), manufacturing (4.15) and production and distribution of electricity, gas and water (4.02) – as well as hotels and restaurants sector (4.14) are critical about the firm-level technology absorption. At the same time, the highest scores come from investment and agricultural firms (4.73 each) as well as banking and construction (4.59 each).

Unlike the availability of the latest technologies where the assessment does not vary greatly by the size of a business, the absorption of new technologies demonstrates direct dependence; the medium-sized organizations tend to absorb the latest technologies more extensively than small businesses (4.34 vs. 4.21), whilst large companies show even more progress (4.60). At the same time, the medium-sized firms upgrade their capital goods more actively. When asked whether investment in fixed assets modernization grew, the executives from medium-sized companies gave the highest assessment – 4.57, which is 0.2 and 0.4 points above the scores given in general by representatives of large and small firms respectively.

The Executive Opinion Survey 2013 suggests, if broken down by sector, the investment in fixed assets modernization have grown in agriculture (4.78), banking (4.77), hotels and restaurants (4.43) and trade (4.42).

Investment and construction companies, the most affected by the financial crunch, give the lowest scores: 3.63 and 3.50 respectively.

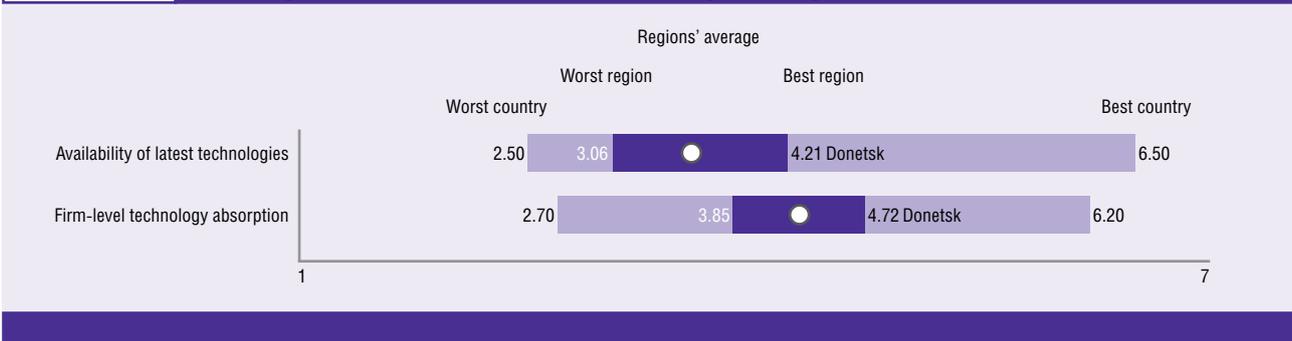
The smallest regions – Volyn (4.73), Chernivtsi (4.61) and Sevastopol (4.65) – are amongst the leaders in upgrading the fixed assets. Larger regions gain the lowest scores: 3.99 for Crimea, 3.87 for Kyiv city and 3.86 for Zaporizhzhya. Incidentally, the State Statistics Service reported in 2012 that Zaporizhzhya Oblast and Kyiv city were among clear outsiders in terms of capital investment gains, while Volyn was among top performers.

Greater sophistication of production processes results partly from the absorption of new technologies and upgrade of facilities. When asked whether production processes in the Oblast were modern, managers gave higher assessments both in large agro-industrial Oblasts (3.70 in Poltava and 3.81 in Kharkiv) and in smaller Oblasts (3.72 in Chernivtsi, 3.73 in Rivne and 3.99 in Vinnytsya). AR Crimea, Kirovohrad and Luhansk are amid Ukraine's worst performers, receiving 3.02, 3.14 and 2.93 respectively.

If broken down by sector, production process sophistication is higher in banks (3.58 points), agricultural firms (3.73), hotels and restaurants (3.91) and lower in electricity, gas and water companies (3.21) as well as mining enterprises (3.26) where depreciation of fixed assets is high.

The country's adaptability and technology gaps from the leading economies are hard to bridge despite efforts of Ukrainian businesses to adapt its business processes to the modern environment and relatively good scores for adaptability in some Oblasts and sectors (including those, which are not obvious forerunners in terms of competitiveness).

**Figure 3.2** Technological readiness indicators of Ukrainian regions and global economies



Source: World Economic Forum, *The Global Competitiveness Report, 2013*; Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

## 3.2 Corporate governance

Depending on the corporate governance sophistication, the management quality, amongst other factors, shapes the ability of the business to develop and adapt to the changing environment.

**CORPORATE GOVERNANCE IS A COMPLICATED SYSTEM OF ENGAGEMENT BETWEEN THE FIRM'S MANAGEMENT TEAM, BOARD OF DIRECTORS, OWNERS AND OTHER STAKEHOLDERS. DEVELOPMENT OF THE CORPORATE GOVERNANCE IS SPURRED BY COMMITMENT OF THE BUSINESS TO SUCCEED IN COMPETITION. ON THE OTHER HAND, IT IS IMPACTED BY REGULATORY FRAMEWORK**

So far Ukraine's business sophistication in general and corporate governance development in particular have not facilitated companies' successful adaptation to global and domestic economic processes. The Change Readiness Index, compiled by KPMG in cooperation with ODI and EIU, ranks Ukraine 37th amongst

60 emerging markets. Such a relatively low position comes from the country's poor performance in the Economic sub-index, which determines change readiness in the business environment (51st place).

This situation is not only peculiar to Ukraine as all post-Soviet nations score poorly for corporate governance, according to Global Competitiveness Report 2013. Ukraine shows evidence of a downward trend in a number of dimensions, with its regions delivering even worse performance (Figure 3.3). If compared with its peers, the country scores for corporate governance indicators are considerably lower in most cases (Figure 3.4).

Ukraine earns the lowest scores for protection of minority shareholders' interests (146th place out of 148 nations). In addition, business executives assess very low the extent of market dominance (132nd place globally). External investor relations are underdeveloped; the fact substantiated with poor scores for the strength of auditing and reporting standards (130th place) and regulation of securities exchanges (129th place in GCI 2013). Furthermore, Ukraine performs even worse over time, losing seven places in the extent of market dominance and four places in the willingness to delegate authority between 2011 and 2013 (see Figure 3.5 for details).

### ASSESSMENT OF CORPORATE GOVERNANCE IN REGIONS

For the purpose of the Report, we can divide indicators measuring the corporate governance effectiveness into two groups: indicators, which depend on commitment of businesses to boost management effectiveness, and indicators, which mainly depend on the government regulation of business environment and establish rules guiding relations of market players. The first group includes metrics that assess the management teams' effectiveness, commitment to delegate authority to other managers and report to stakeholders. The second group evaluates business development in the context of existing regulation of relations with shareholders, investors and competitors.

### Efficacy of corporate boards

The Survey's respondents assessed the efficacy of corporate boards through the prism of relations between business owners (investors) and senior managers, namely managers' accountability to the owners (investors). Executive Opinion Survey 2013 shows that Ukraine's average score of 5.11 is above the global average of 4.51 scores, at the same level as the UAE (24th place globally). To a certain extent, such high results are down to a relatively small number of public joint-stock companies in Ukraine's corporate sector: sole or few owners are very often directly involved in business administration, being in fact a part of the management teams.

Donetsk (5.44 scores), Zaporizhzhya (5.40 scores) and Sumy (5.40 scores) are the top performers in the efficacy of corporate boards, at the level of Luxemburg (5.49 scores) or the Netherlands (5.47 scores). The lowest scores are in the Autonomous Republic of Crimea (4.77 scores), Chernivtsi (4.78) and Chernihiv (4.89 scores), which is comparable to Latvia or Kazakhstan (4.8 scores each). The economy of scale is quite evident: large companies enjoy higher efficacy of corporate boards (5.34 scores) than small ones (5.14 scores). Cross-industrial comparison suggests that banks, insurance (5.35 scores) and investment (5.33 scores) companies are leaders, while hotels and restaurants (4.95 scores) are underachievers.

### Reliance on professional management

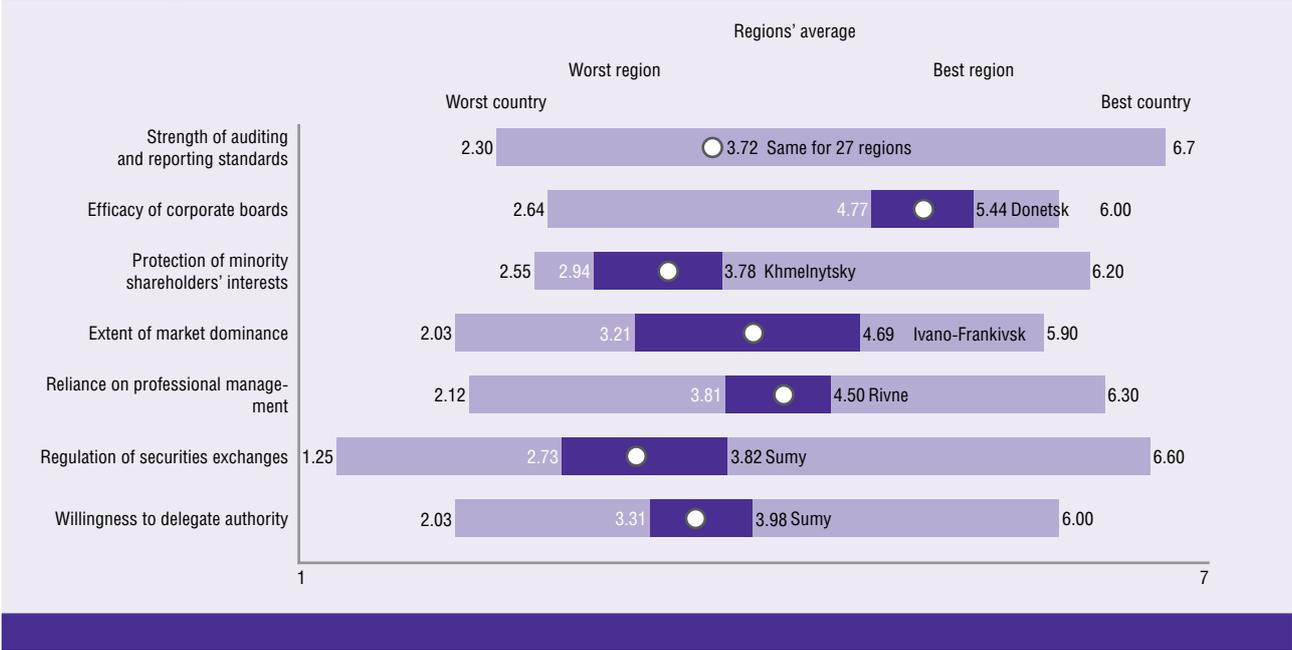
To ensure business efficiency, companies should engage top professionals selected in competition and capable of making very competitive decisions to take key management positions. The assessment of reliance on professional management demonstrates who takes key management posts – either relatives and/or friends irrespective of their skills and qualifications or professional managers selected for their high qualifications and hands-on experience.

Ukraine performance scores 4.19 in this indicator on average, similar to the world's average (4.3) but below Kazakhstan (4.26 scores), but above the Slovak Republic (4.16 scores). Khmelnytsky (4.48), Zhytomyr (4.42) and Rivne (4.50 scores) earn the highest assessment matching the result of Lithuania (4.57 scores). Chernivtsi (3.81), Lviv (4 scores) are most critical about the reliance on professional management, with the performance quite comparable to Azerbaijan or Armenia (3.9 scores each). The gap in scores is observed in companies of different size: from 4.18 scores in small businesses to 4.52 in large firms. Unlike the efficacy of corporate boards, hotels and restaurants (4.60 scores) and mining industry (4.51 scores) give the highest assessment of the reliance on professional management, while production and distribution of electricity, gas and water assign the lowest score (4.04 scores).

### Willingness to delegate authority

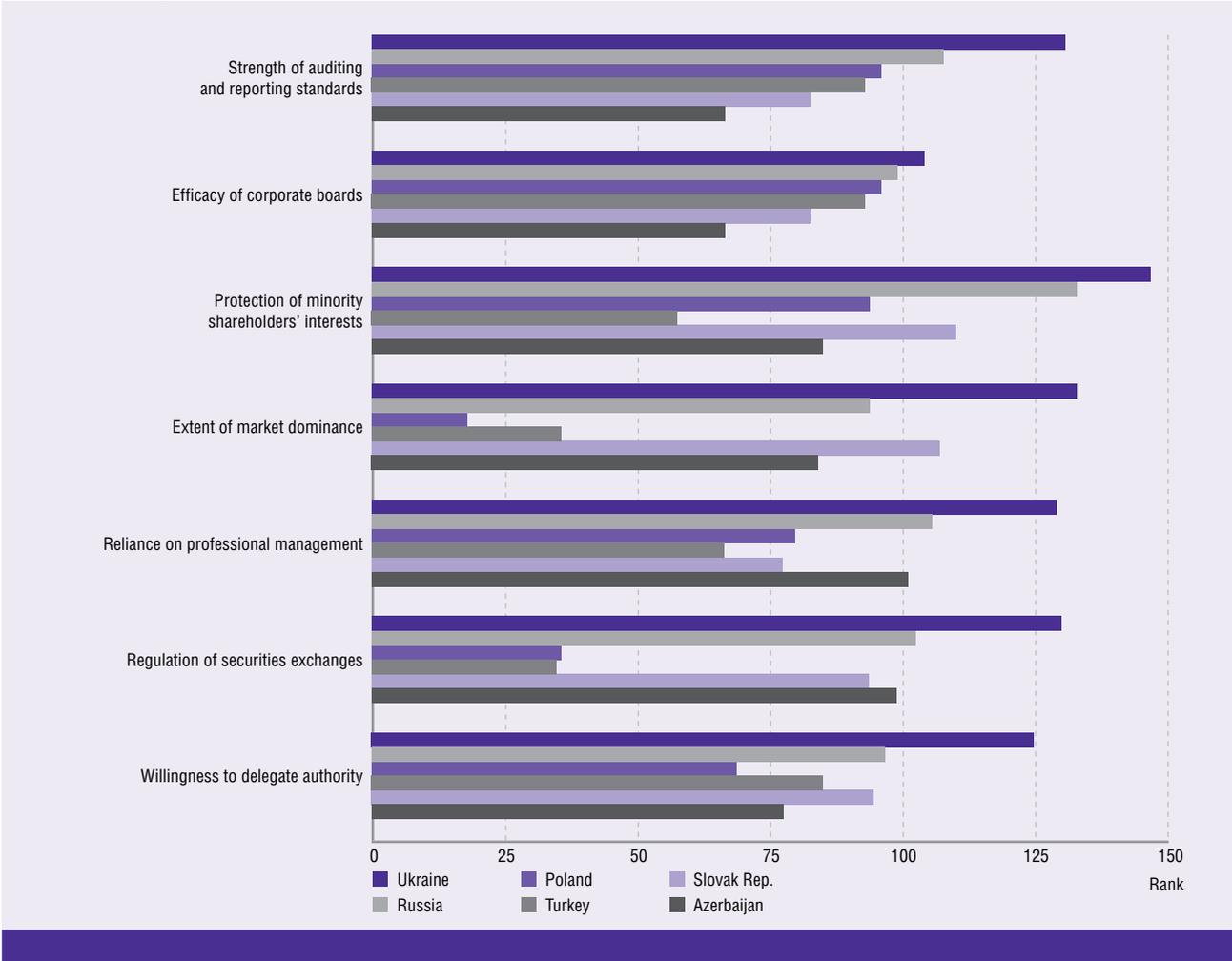
The management's willingness to delegate authority is an essential element of the management function in a company. Delegation of authority helps to build an effective management hierarchy and ensure the best distribution of workload to meet strategic and operational objectives. If a senior manager consolidates all his powers to hand, he will appear to be over loaded with work and gets distracted from

**Figure 3.3 Corporate governance scores of Ukrainian regions and global economies**



Source: World Economic Forum, *The Global Competitiveness Report, 2013*; Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

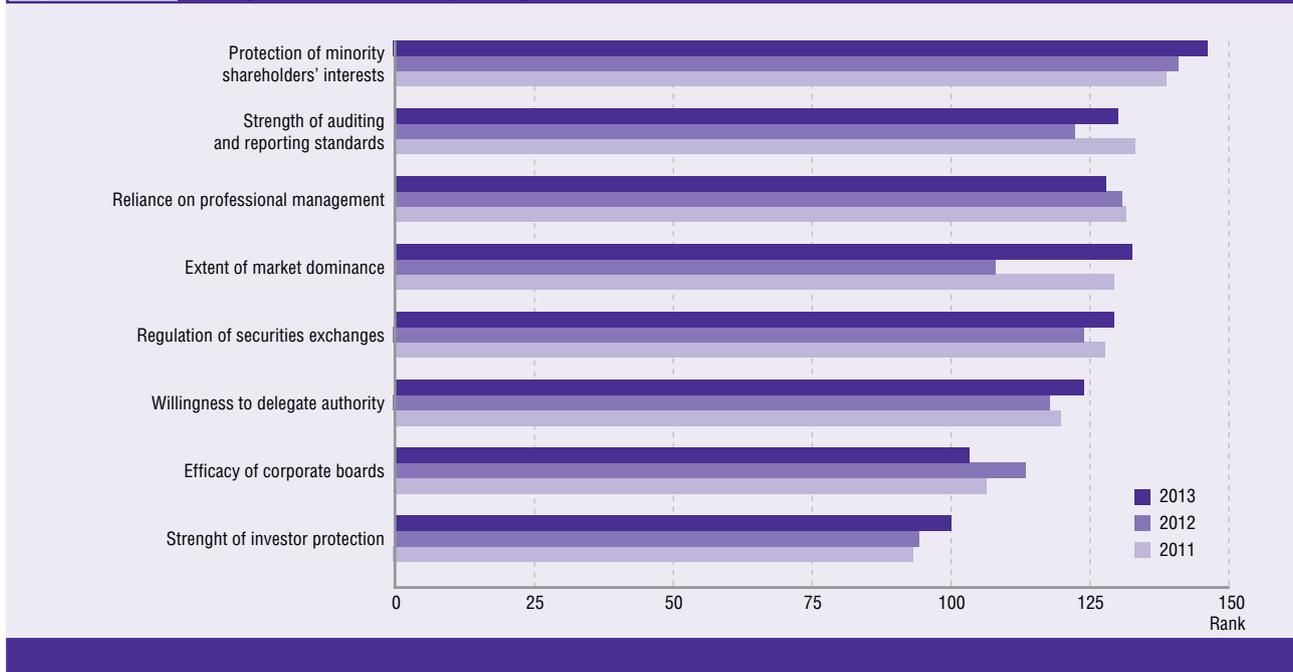
**Figure 3.4 Performance of Ukraine and peer countries in corporate governance indicators**



Source: World Economic Forum, *The Global Competitiveness Report, 2013*.

business objectives intrinsic to his hierarchy level. Thus, his effectiveness and efficiency get worse. On the other hand, his subordinates (lower-level managers) cannot fully utilize their potentials, losing motivation to achieve competitive results.

According to Executive Opinion Survey 2013, the country's average in the willingness to delegate authority scores 3.61, which is below the global average (3.79) and corresponds to the same level as Turkey or Bosnia and

**Figure 3.5** Changes in Ukraine's corporate governance indicators in the GCI

Source: World Economic Forum, *The Global Competitiveness Report, 2011-2013*

Herzegovina (3.62 scores and 3.58 scores each). From a regional perspective, Sumy (3.98 scores), Khmelnytsky (3.87 scores) and Ivano-Frankivsk (3.85 scores) give the highest assessment of the willingness to delegate authority, while Kirovohrad (3.31 scores), Ternopil (3.32 scores) and Sevastopol (3.36 scores) give the lowest scores. Delegation of authority in Ukraine's large businesses (3.79 scores) merely matches the average value of the GCI nations (approximately at the same level as Poland), however it is lower in domestic medium-sized enterprises (3.58 scores). The sectoral gap is quite significant – from 2.66 scores (investment firms) to 4.57 scores (hotels and restaurants).

### Strength of auditing and reporting standards

Business transparency and reporting standards are an essential element of effective management as they help to build trust within business partners and public reputation, determine credit risks and thus the cost of debt raised for business development needs. Although the requirements for auditing and reporting standards are established by law, compliance depends on the business itself.

Ukraine's score for the strength of auditing and reporting standards is 3.72 scores (130th place globally), being below the GCI's average for 148 countries (4.55) and the worst result for the CIS countries.

### Protection of minority shareholders' interests

Protection of minority shareholders' interests against abuse by majority shareholders or senior managers is a pressing issue in regulation of corporate relations in Ukraine. Players operating in markets with numerous public joint-stock companies need to be confident that interests of an owner who holds even one share would be considered and that the companies' management or majority shareholders would not exercise their influence entirely to their own benefit. If there is no confidence, businesses suffer from fewer opportunities to attract investment through equity market.

Survey 2013 suggests that Ukraine's average score for protection of minority shareholders' interests is only

3.36. This is at the same level as Romania at 128th place (3.34 scores), considerably below the global average of 4.14 scores. A regional breakdown shows that minority shareholders' interests are most protected in Khmelnytsky (3.78), Sumy (3.77) and Chernihiv (3.75 scores), which perform approximately at the same level as Armenia (3.77) or the Czech Republic (3.95 scores). Exceptionally low scores are in Cherkasy (2.94) and Odesa (3.05 scores) Oblasts and city of Kyiv (3.07 scores) close to Serbia's (with score of 2.7 and 144th place amidst 148 countries). In terms of economy branches, banking (3.82) and hotels and restaurants (3.75) sectors give relatively high assessment for this indicator, while trade (3.10) and construction (3.13 scores) deliver the worst results. Business size does not entail any significant gap in scores although large companies take the lead (3.47, like Moldova or the Kyrgyz Republic with 3.5 scores).

### Extent of market dominance

Free and fair competition encourages higher quality of corporate governance yet environment supporting the competition should be developed both at the macro- and micro-levels (largely though antimonopoly regulation).

In Ukraine, the extent of market dominance gains the average score of 3.99, which is a little (by 0.19 points) above the average value globally and matches 53rd position (above Estonia at 57th place). In a regional breakdown, Ivano-Frankivsk enjoys the lowest extent of market dominance (4.69), performing nearly at the same level as Poland at 17th place (4.8 scores). Donetsk Oblast with 3.21 scores has the highest market dominance, comparable with South Korea (3.25 scores, 118th place), where *chaebols* (large business groups) dominate.

According to the Survey, Ukraine cannot boast of effective corporate governance. In general, assessment of corporate governance dimensions signals uncompetitive Ukrainian business although large companies seeking to develop corporate governance principles have higher scores for some abovementioned indicators than the national average.

### 3.3 Corporate ethics

The increasing global attention to the soft factors of business sophistication has become an important trend of recent years. Such factors include (but not limited to) ethical behaviour of firms, corporate social responsibility and staff policy. They help to improve relations between different groups of stakeholders, both internal and external, and increase the companies' value by using such intangible assets as reputation and ethics. Indeed, corporate ethics plays an important role because of the risk of losing reputation with internal and external stakeholders.

**BUSINESS ETHICS ARE ABOUT CERTAIN CULTURE OF INTERACTION BETWEEN MANAGEMENT AND STAFF, ON THE ONE HAND AND EXTERNAL STAKEHOLDERS ON THE OTHER HAND, QUITE OFTEN ON THE BASIS OF CODE OF ETHICS OF THE COMPANY, STARTING FROM INFORMAL RULES AND ETHICAL GUIDELINES AND TO OFFICIAL MISSION OF THE COMPANY AS BEHAVING ETHICALLY HELPS BUSINESS TO ENHANCE ITS COMPETITIVE POSITIONS IN THE LONG TERM**

The Executive Opinion Survey demonstrates that despite the high interest of Ukrainian companies to the issue of corporate ethics there are very few companies in the country taking real actions in this regard. Thus, only 28% of large Ukrainian companies have approved values and codes of business conduct (according to the report "CSR 2005-2010: Current state and development perspectives", UNITER, 2011).

According to WEF's Global Competitiveness Report 2013, Ukrainian companies fall behind most peer countries in ethical behaviour of firms (130th out of 148 nations). The low performance of the country in the indicator is also confirmed by the fact that not a single Ukrainian company has ever entered the World Most Ethical Companies (annual list of the world's most ethical companies compiled by the Ethisphere Institute). The reasons for such poor performance of the Ukraine in corporate ethics include the high level of corruption, low level of local competition, and poor relations with consumers (Figure 3.6).

The following factors affect the ethical relations between business and government (B2G), business and other businesses (B2B) and business and consumers (B2C):

B2G: Widespread corruption practices (130th) and very low level of judicial independence (139th).

B2B: Low level of competition in the internal market (106th globally), taking into account that corporate ethical behaviour is not regarded as a tool of competitiveness.

B2C: Very small share of companies building trustworthy and long-term relations with consumers (both, with the use of hard approaches (like IT solutions, e.g. CRM) as well as soft informal approaches).

The Executive Opinion Survey carried out by the Foundation for Effective Governance in 2013 reveals regional features of ethical behaviour of firms. Thus, the average assessment of ethical behaviour of firms in all the Ukrainian regions, with a score of 3.58. This score is relatively low in global scale, approximately at the level of Russia (101st, in 2013).

The regional disparity is not that large as all the Ukrainian regions receive poor assessment in this indicator. The

regions demonstrating the highest level of ethical behaviour include Poltava (3.76), Donetsk (3.84) and Dnipropetrovsk (3.84) Oblasts. Volyn (3.35), Kherson (3.35) and Ivano-Frankivsk (3.36) are the Oblasts with the lowest level of ethical behaviour. If reviewed by sector, banks (4.07), transportation and communication companies (3.88), and hotels and restaurants business (3.28) demonstrate strong ethical practices. It is worth noting that the first two sectors are subject to stringent industry regulation. Mining companies (3.3), trading area (3.41) and construction firms (3.58) are the least ethical sectors.

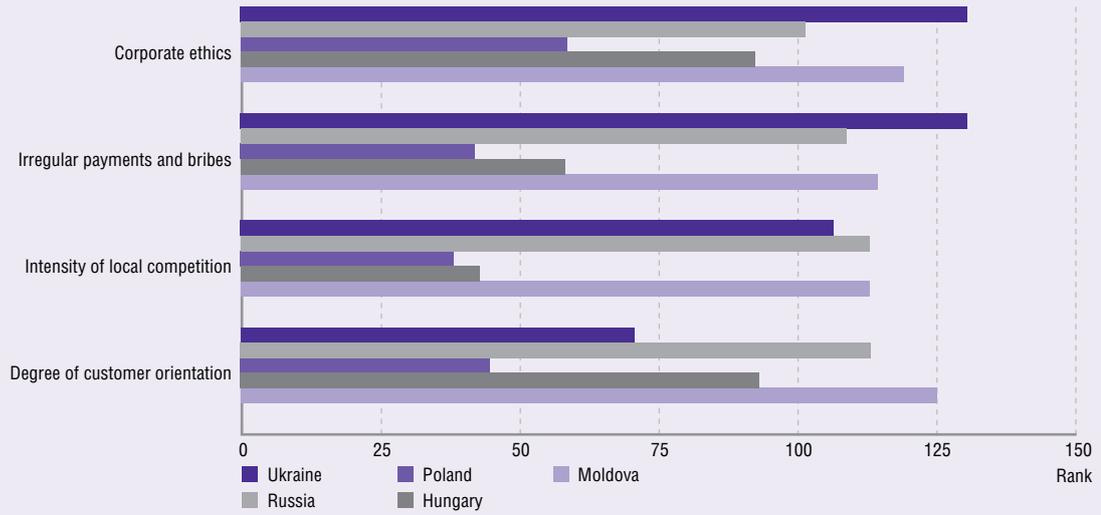
Perhaps, the highest level of corporate ethics is found in B2B relations, in the context of two dimensions: high importance of business reputation and ethical behaviour in fulfilment of obligations. Business reputation is very important for business: on average, business executives of Ukrainian Oblasts regard it as the main asset (scoring 6 out of 7). Companies in Kirovohrad and Odesa Oblasts and Sevastopol City value reputation more than other Oblasts (6.28, 6.18 and 6.19 respectively). Rivne, Kherson and Cherkasy believe that reputation is of high importance less than other regions (5.59, 5.75 and 5.77). The breakdown by sector shows that financial sector is more worried about their reputation (banks with score of 6.39; insurance companies with 6.25) compared with resource-based sectors (mining industry with 5.47; electricity, generation companies and gas and water production and supply companies with 5.61). The disparity in regards to the size of the business is insignificant.

In general, Ukrainian businesses are satisfied with partners' ability to meet business obligations, with the regional average of 4.44. Business executives of Sevastopol (4.77), Cherkasy (4.76) and Kirovohrad (4.73) Oblasts are mostly satisfied with the ability of their partners to meet their obligations, while Kyiv City, Chernihiv and Kherson Oblasts (4.02, 4.02 and 4.18 respectively) are rather not so happy with this indicator. Sectoral analysis shows that business executives of investment companies give a high assessment score for the ability of their partners to meet obligations (4.92), while executives of construction companies poorly assess performance of their partners in this area (3.86). Executives of large companies usually value trust relations with their partners more than others.

**UKRAINIAN REGIONS SUFFER FROM TENSE B2G RELATIONS AS A RESULT OF HIGH JUDICIAL DEPENDENCE, CORRUPTION / BRIBERY PRACTICES AND USE OF CORRUPTION SCHEMES FOR GETTING THE STATE BUDGET MONEY**

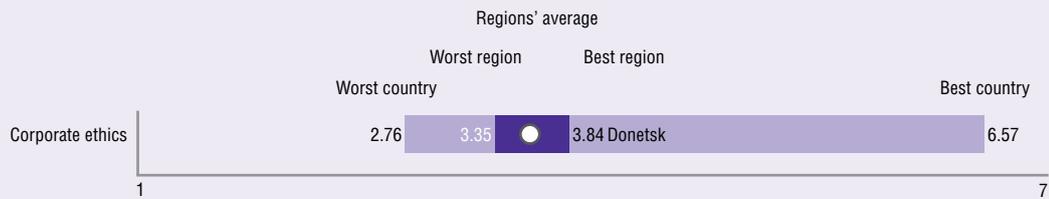
Businesses identify the low level of judicial independence, as courts depend on power authorities, business and individuals to a great extent (the regional average of 3.05, at the level of 109-110th places, obtained by Croatia and Armenia). Large regions, most of all, Kyiv City (2.41), Odesa (2.50) and Crimea (2.72) show the worst performance in this indicator. The best performing Oblasts include Volyn (3.59), Chernihiv (3.43) and Zhytomyr (3.36). However, their scores correspond to approximately 90th place, at the same level as Kazakhstan, Georgia, or

**Figure 3.6** Indicators affecting corporate ethics in Ukraine and peer countries



Source: World Economic Forum, Global Competitiveness Report, 2013

**Figure 3.7A** Comparison of corporate ethics in Ukrainian regions and global economies.



Source: World Economic Forum, The Global Competitiveness Report, 2013; Foundation for Effective Governance, Executive Opinion Survey, 2013.

**Figure 3.7B** Corporate ethics indicators in Ukrainian regions.



Source: World Economic Forum, The Global Competitiveness Report, 2013; Foundation for Effective Governance, Executive Opinion Survey, 2013.

Azerbaijan. Business executives of large companies note that judicial system is highly affected by third persons (2.90). Their opinion is shared by executives of investment companies (2.55), banks (2.8) and mining industry (2.74).

As usual, businesses identify that obtaining money by corruption from the state funds has become common practice: the regions' average makes 3.65 scores. Large regions suffer more from corrupt practices: Kyiv City (2.59 scores), Dnipropetrovsk (3.09) and Donetsk (3.17) Oblasts. The best situation is in Poltava (4.20 scores), Chernihiv (4.10), and Vinnytsya (3.91) Oblasts.

Interestingly enough, according to business executives, the widespread corrupt practices in companies mostly refer to additional irregular payments and bribes in connection with obtaining court rulings (3.32), state orders and licenses

(3.61), export and import operations (3.90). Corruption is less likely to occur in such areas as tax payments (4.39) and interaction with utility services (5.07).

Assessment of ethical behaviour of firms shows that on the one hand business executives understand and advocate the importance of corporate ethics and some of them even seek to do business on the basis of ethical standards. On the other hand, in reality ethical behaviour in every aspects of their activity is rather an exception than a rule. The probable reason for such behaviour can be the possibility to bypass the rules and stay unpunished (for example, by using corrupt practices in B2G relations) as well as failure to solve the problems without irregular payments (bribery). It is for this reason that ethical behaviour of firms is assessed high in B2B relations where there are market mechanisms in place.

### 3.4 Corporate social responsibility

Corporate social responsibility (CSR) contributes to sustainable business development as it takes into account the interests of different groups of stakeholders and, in particular, the community of the Oblasts where the company operates. At present CSR is regarded as an investment in sustainable development of business in the long term. The world practice shows that in most cases CSR is regarded as an integral part of the key business activity.

**CORPORATE SOCIAL RESPONSIBILITY OF BUSINESS REFERS TO VOLUNTARY ACTIONS UNDERTAKEN BY BUSINESS TO TAKE INTO ACCOUNT THE INTERESTS OF THE PUBLIC, EMPLOYEES, PARTNERS AND OTHER STAKEHOLDERS**

The importance of CSR for business in the Ukraine is confirmed by some research: 38% of companies note that CSR can boost sales and 19% state that they implement CSR policies to emulate the actions of competitors (according to the report CSR 2005-2010, UNITER, 2011).

The major constraint facing business in implementing CSR policies is the shortage of available funds, in particular after the financial recession of 2008-2009. Thus, 61% of the national companies (especially small business) do not regard CSR as their priority objective because of lack of funds, while just 17% of companies (large business mainly) allocate special budget for such purposes (according to CSR 2005-2010, UNITER, 2011). At the same time, over a half of Ukrainian companies (57%) believe that CSR refers to charity actions, despite the fact charity is not considered as a kind of CSR activity in the world.

It is quite possible that reluctance of business to spend for CSR in general also results from lack of habit to support people in need. Thus, the Ukrainian society ranks 111th (out of 153) in generosity in giving money with only 7% of people ready to make cash charitable contributions according to World Giving Index 2012 (according to the poll of over 150,000 respondents in 153 nations of the Gallup World View 2011, see Table 3.2):

According to the Executive Opinion Survey, in most cases CSR policies in the Ukraine refer to internal staff policy, first of all, HR development projects (4.16

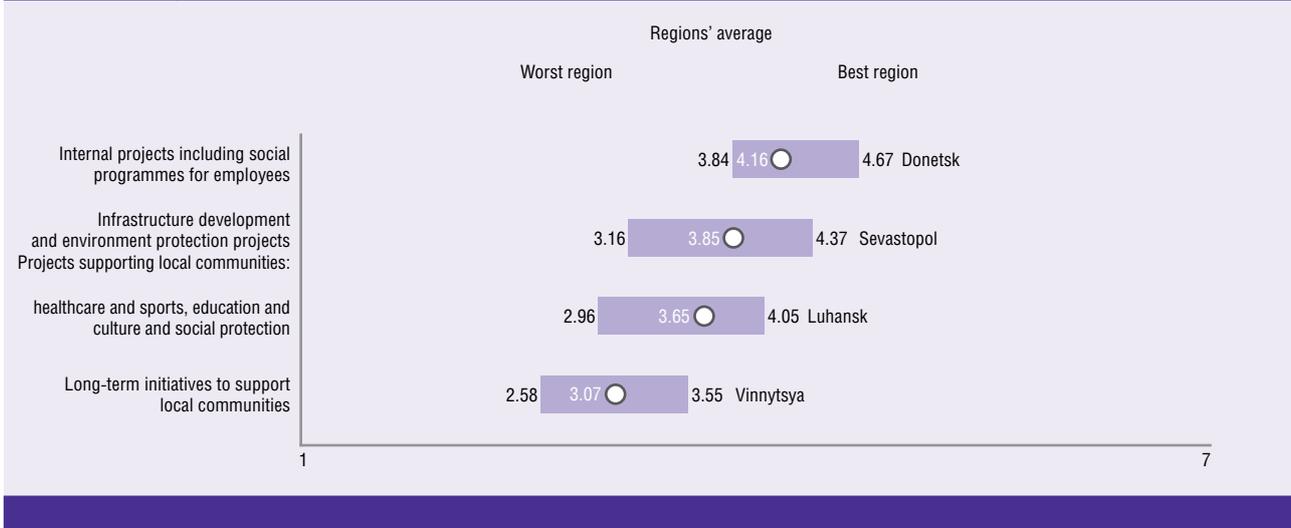
out of 7, Ukraine's regional average). Lower attention is given to participation of business in environmental and infrastructure projects in the Oblasts of their operation (3.85) and projects with public engagement (3.68) in such areas as healthcare and sports, education and culture and social security.

Internal projects including social programmes for employees enjoy the biggest popularity, according to the survey carried out by the Foundation for Effective Governance. In Sevastopol City, Mykolayiv and Chernivtsi Oblasts the companies are more likely to finance staff development projects (4.67, 4.54 and 4.53 respectively). In Chernihiv, Kherson and Rivne Oblasts this area is not so popular (3.84, 3.88 and 3.95). It is worth noting a wide disparity in this indicator by sectors. Thus, agricultural companies (4.79) and banks (4.46) are more likely to invest in social projects, while investment companies are rather not interested in programmes for their staff (3.00). Mid-sized business gives the best scores (4.74) at the same time.

Table 3.2		Ukraine and peer countries in World Giving Index	
Country	Place (out of 153)	Cash donations (%)	
Slovak Republic	79	37	
Moldova	88	19	
Belarus	91	16	
Hungary	94	26	
Poland	94	28	
Czech Republic	98	27	
<b>Ukraine</b>	<b>111</b>	<b>7</b>	
Romania	119	20	
Russia	127	7	
Bulgaria	137	10	
Average in CEE countries	104	20	

Source: Charities Aid Foundation, Global World Giving Index, 2012.

The Oblasts engaged in infrastructure development and environment protection projects include Poltava (4.32), Vinnytsya (4.26) and Kherson (4.37). Amongst the outsiders are Kyiv City (3.16), Rivne (3.40) and Chernihiv (3.42) Oblasts. Often agricultural companies are engaged in this type of activity more than other businesses.

**Figure 3.8** CSR related indicators in Ukrainian regions.

Source: Foundation for Effective Governance, Executive Opinion Survey, 2013.

The CSR policy of Ukrainian companies also focuses on the projects supporting local communities in such areas as healthcare and sports, education and culture, social security: the average regional score is 3.65. The Oblasts with high level of participation in such projects include Kirovohrad (4.05), Chernivtsi (4.04), Kherson (4.03) and Khmelnytsky (4.00). The assessment of business participation in local community development in Donetsk and Lviv Oblasts as well as in Kyiv City is low (3.41, 3.46 and 2.96 respectively). Agricultural companies have got the highest scores in this dimension (4.62) which could be explained by their direct engagement into the communities' everyday life.

Business long-term initiatives to support local communities are assessed poorly, with the Oblasts' average scores of 3.07. Only 42% of respondents note that their companies provide some help to their Oblasts. Mostly they help to improve the areas (31%) and create jobs (19%, which again refers to internal staff policy). Companies in Kirovohrad (3.55), Zakarpattya (3.53) and Ivano-Frankivsk

(3.44) Oblasts are the major contributors in creation of long-term programmes in their Oblasts. Companies in Kyiv City and Odesa Oblast are less active, with scores of 2.58 and 2.84 respectively. The industries which cannot pursue short-term profits due to their production cycles show the highest level of participation in long-term programmes in their Oblasts: electricity, gas and water production and distribution companies (3.95), agricultural firms (3.74) and mining enterprises (3.42). The sectors requiring small capital investment are less interested in long-term programmes: financial services (investment (2.33) and insurance (2.61) companies) and trade (2.65).

Thus, to conclude, although Ukrainian business realizes the role of CSR as a tool to improve its reputation and overall competitiveness as a result quite often it is slow in implementing CSR policies due to lack of funds. In most cases CSR is not the area which is pursued regularly or regarded as a priority. CSR policy of Ukrainian companies focuses mostly on internal projects connected with own staff.

## 3.5 Human resources

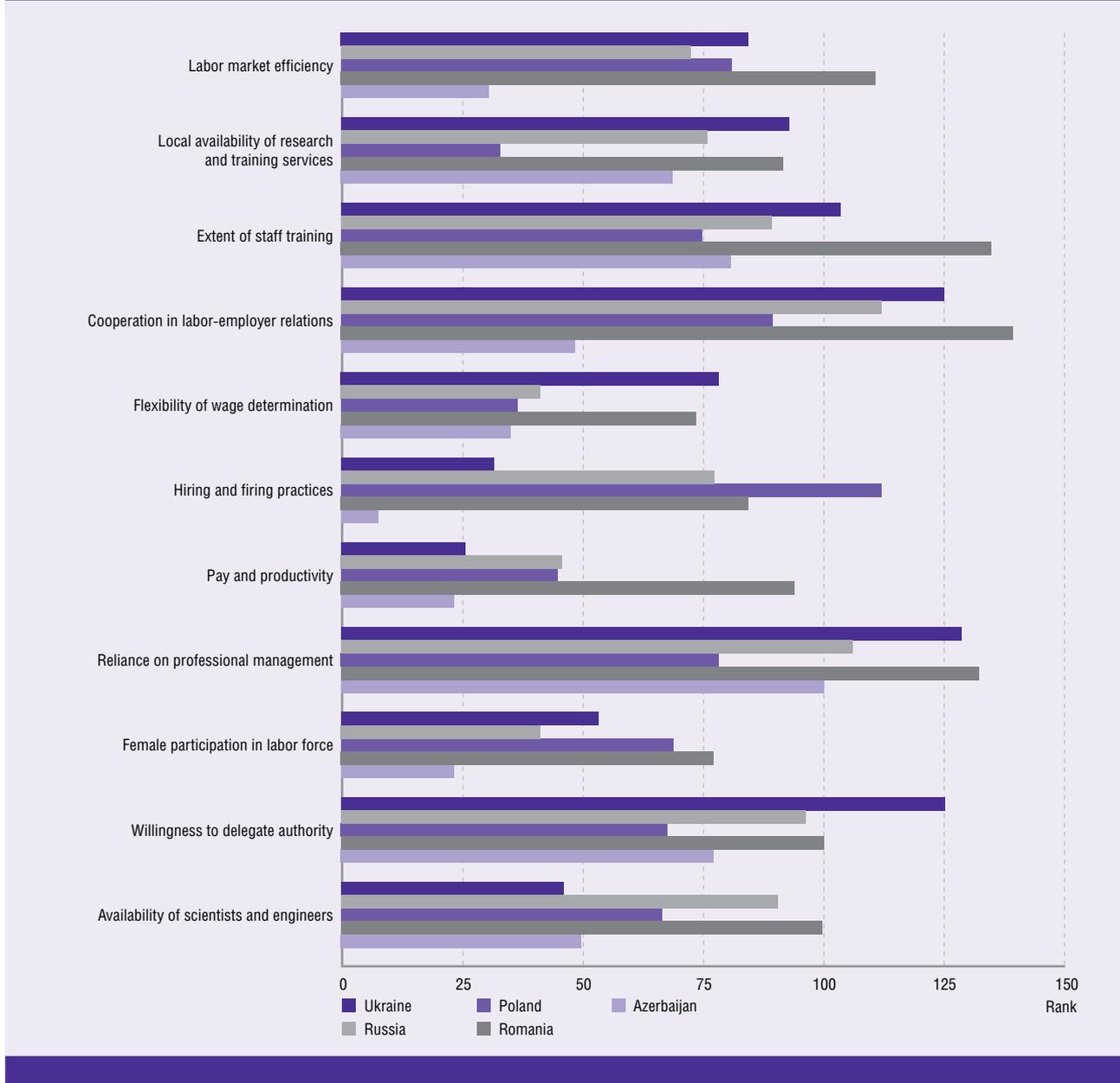
Inefficient labour market reduces Ukraine's competitiveness both in economic and social dimensions. According to GCI compiled by WEF, the factors contributing to higher labour market efficiency and flexibility include high quality of management, availability of scientists and engineers, extent of staff training, direct dependence between pay and productivity, gender equality in labour force, and compliance with hiring and firing standards.

LABOUR MARKET FLEXIBILITY MEANS THAT EMPLOYER/EMPLOYEE RELATIONS ARE BASED ON TRUST. LABOUR MARKET EFFICIENCY AND FLEXIBILITY GIVE A CHANCE TO IMPROVE EMPLOYEES' PERFORMANCE RESULTS AND RETAIN AND ATTRACT TALENTS TO THE COUNTRY

This can be seen, for example within Ukraine, where there is a wide gap between supply and demand. In 2012,

the demand to supply ratio in the official labour market was 1 to 11 (can be compared with 1 to 8 in 2011), according to the State Statistics Service. In addition, the regional disparity in official salary is 1 to 2 (Ternopil Oblast and Kyiv City in 2013). In fact, nowadays Ukraine faces a deadlock, as on the one hand the employers want to have highly-skilled labour force on board, but they are not ready to pay good salaries, improve skills or provide career opportunities, and on the other hand, skilled employees are not satisfied with the working conditions and do not have any incentives to improve their performance. The results of WEF's Global Competitiveness Index confirm the fact: cooperation in labour-employer relations is very low and the relations are very tense (125th position out of 148 countries in 2013).

As a result, according to GCI 2013 (WEF) the labour market efficiency is not a competitive advantage of Ukraine anymore as Ukraine ranks 84th out of 148 countries globally (62nd place in 2012). Ukraine falls behind Azerbaijan (30th

**Figure 3.9** Human resources indicators in Ukraine and peer countries

Source: World Economic Forum, *The Global Competitiveness Report*, 2013.

place), Russia (72nd place), Slovak Republic (76th place) and Poland (80th place) but outperforms Turkey (130th place) and Romania (110th place). It is still worth noting that over the last year the performance of peer countries in labour market efficiency has also deteriorated: Romania is down 6 positions and Azerbaijan loses 4 positions in the ranking.

The situation in Ukraine is getting worse as experience and qualifications are not seen as the main criteria to be elected to high positions in the company (128th place); talents migrate to other countries (140th place in capacity to retain talents and 136th place in capacity to attract talents); willingness to delegate authority is low (124th place); cooperation in labour-employer relations is low (125th place); and management is not interested in staff training and development (103rd place). At the same time competitive advantages of Ukraine's labour market are good in respect to hiring and firing practices (32nd place), good pay and productivity ratio (26th), and high level of availability of scientists and engineers (46th place).

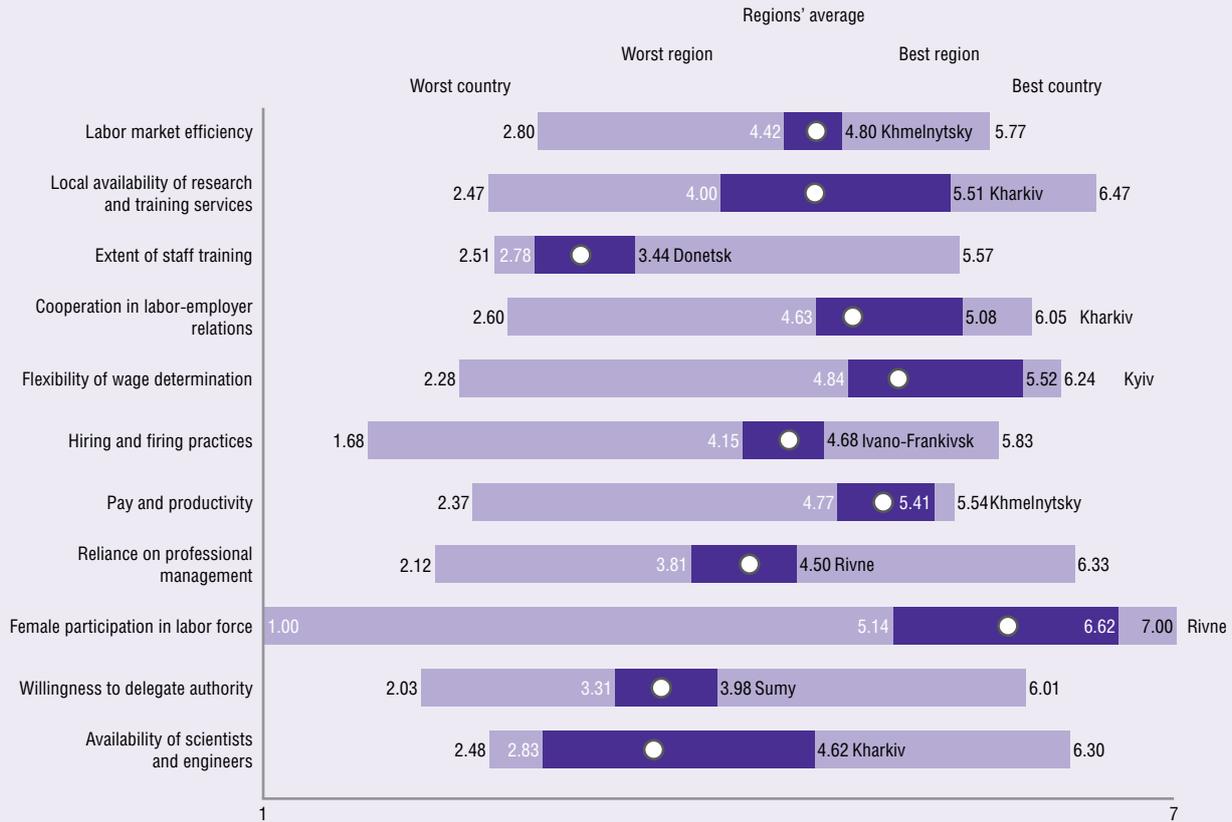
From 2011 to 2013 the most negative trends has been observed in flexibility of wage determination (a loss of 20 positions, 79th place in 2013). There is a sharp drop in cooperation in labour-employer relations (down 16 positions, 125th place in 2013). At the same time, the pay and productivity indicator has improved: up 16 positions (26th place in 2013) and business executives pay more attention to staff training and development (up 14 positions, 103rd place in 2013).

## ASSESSMENT OF HR POLICIES IN REGIONS

### Motivation, pay and productivity

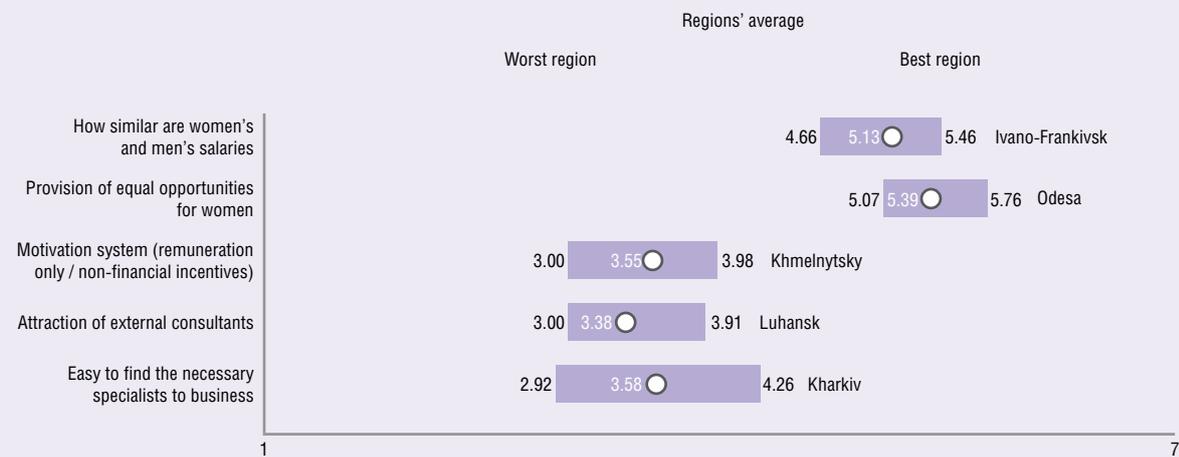
The GCI methodology suggests that business which uses equally all levers to motivate staff, both material and non-material incentives, is more competitive. Certainly, motivation systems are different in each company and they also differ by regions. Despite of similar and low average estimates of non-material incentives used by businesses in all Ukrainian regions, Khmelnytsky and Odesa Oblasts

**Figure 3.10** Human resources indicators for Ukrainian regions and global economies.



Source: World Economic Forum, *The Global Competitiveness Report, 2013*; Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

**Figure 3.11** Assessment of the motivation problems and talent management in Ukrainian regions.

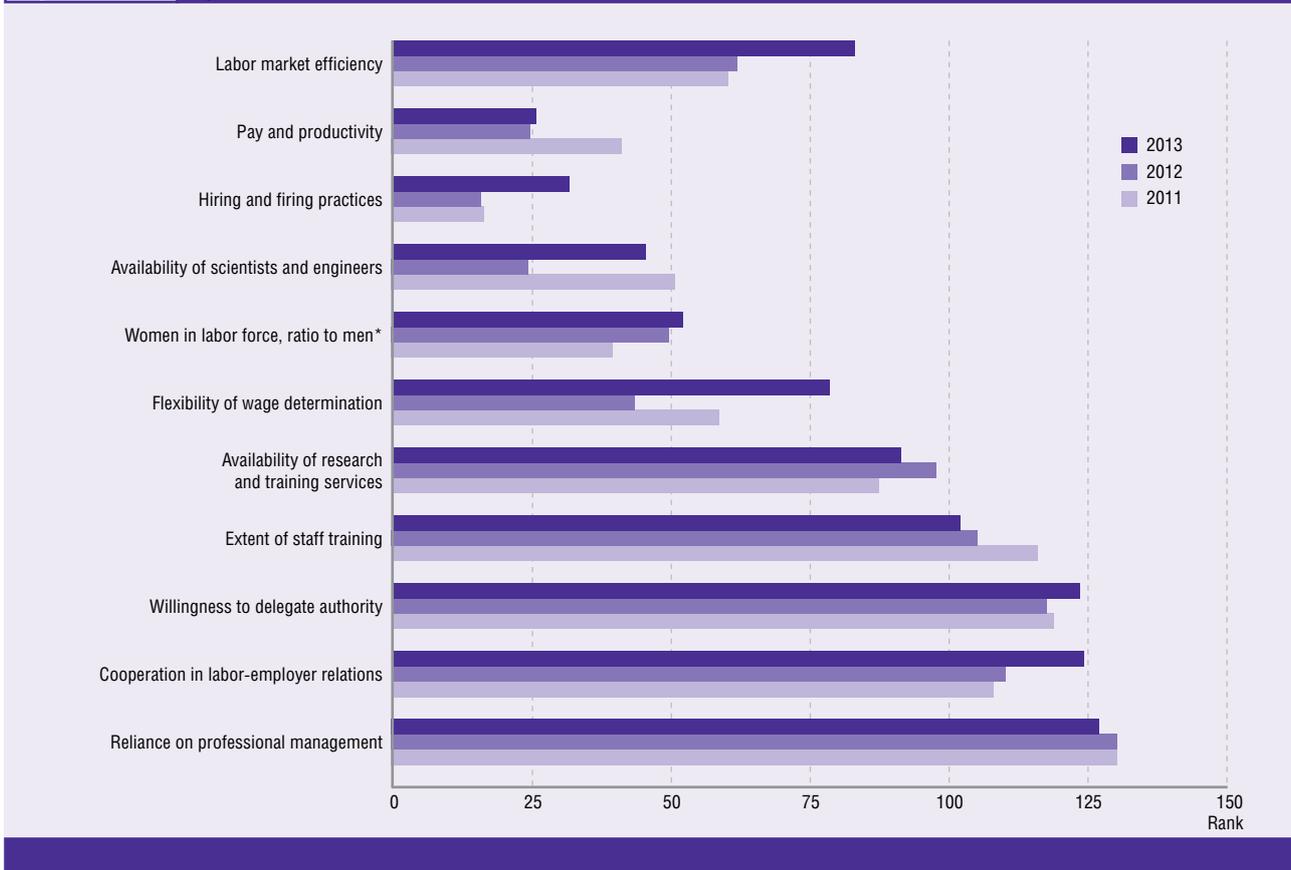


Source: Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

motivate their employees with the help of different non-material incentives (3.98 and 3.91 scores respectively) rather than only with material incentives. At the same time Poltava and Ternopil Oblasts are more focused on material incentives (3 and 3.18 scores) Construction companies and banks use non-material incentives more often compared with other sectors (4.02 and 3.86 scores), while companies in resourced-based industries like mining (3.24 scores) and electricity, gas and water production and distribution (3.33 scores) as well as construction (3.33 scores) are less likely to use non-material incentives. In general, non-material incentives are not widespread in businesses of any size.

In the context of free and efficient labour market the workers' pay should directly depend on their productivity: the higher employees' productivity, the bigger their remuneration. According to GCI 2013, the pay and productivity indicator in Ukraine scores 4.50, at the same level as Saudi Arabia with 4.52. Meantime, the average salary in Saudi Arabia is 4-5 times higher than that in Ukraine. These disparities confirm that good pay and productivity is ensured through low level of salaries and hence low level of productivity.

The regional average of pay and productivity in the Ukraine scores of 5.07. This is much higher than the global

**Figure 3.12** Dynamics of human resources indicators.

Source: World Economic Forum, *The Global Competitiveness Report, 2011-2013*.

average among 148 nations (3.87 scores). The workers' pay depends on their productivity to a large extent in Khmelnytsky (5.41) and Lviv (5.29 scores) Oblasts. In Poltava Oblast and Kyiv City the pay and productivity ratio is lowest (4.77 and 4.81 scores respectively) albeit they have a twofold difference in the average salary level. Business executives believe that the sectors with higher pay and productivity ratio include the construction branch (5.51), agriculture (5.33) and the hotel and restaurant businesses (5.18 scores), while the financial sector has less dependence between pay and productivity (4.33 scores for investments companies and 4.6 for banks). The company size does not affect the indicator.

### Talent management

Talents (highly skilled and efficient staff) are an important element of competitiveness both for business and for the country as a whole as they hold the key management positions in all areas of the companies' activity, make the most successful strategic decisions and scientific discoveries, ensure development and implementation of new technologies in management and production. According to Global Talent Index 2011 (the project of The Economist Intelligence Unit assessing the countries' capacity to develop, attract and retain talents), Ukraine ranks 43rd (38 scores) among 60 countries. A number of peer countries significantly outperform Ukraine, including Poland (29th), Slovak Republic (32nd), Russia (34th) and Romania (36th). At the same time Ukraine is ahead of Bulgaria (49th) and Azerbaijan (54th). According to this Index forecast, the situation in Ukraine is expected to slightly improve before 2015 (40.3 scores, up to 42nd place).

One of the conditions for development of talent inside the company is availability of training services at the local market. According to the Survey, Ukraine's average score is 4.62. This is better than the global average of 4.17. Availability of high quality specialized training services is higher in Kharkiv Oblast (5.51) and Kyiv City (5.22 scores). Chernihiv and Poltava Oblasts do not provide good opportunities for training (4 and 4.28 scores respectively). Large companies invest more in training of their staff (4.9 scores) though small companies have also a relatively high score (4.68 scores).

That is hugely important, however, how the business want to spend for their employees' improvement. In fact, this indicator is critical for all Ukrainian regions since companies are not willing to invest in their staff. In large industrial regions like Donetsk and Kharkiv business executives are more likely to improve the skills of their staff and allocate slightly higher budgets for such purposes (3.44 scores and 3.31 scores respectively). On the contrary, executives are less likely to improve staff skills in Luhansk (2.78), Lviv (2.87 scores), Ternopil (2.89 scores) Oblasts. If taken by sectors, the ranking leaders are the financial sector (insurance companies with 3.88; investment companies with 3.75 scores) and hotels and restaurants business (3.48 scores). Amongst the outsiders there are the companies working in electricity, gas and water production and distribution (2.98 scores). The business size does not influence results as a rule.

### Gender equality

According to Women's Economic Opportunity Index 2012 (compiled by The Economist Intelligence Unit

in partnership with the Vital Voices Global Partnership, LaPietra Coalition) which measures specific attributes of the environment for women employees and entrepreneurs in 128 economies, Ukraine ranks 57th in gender equality (55.4 scores). Compared with last year the situation in Ukraine has improved (by 2.1 points), although Ukraine falls behind such peers as the Slovak Republic (26th place), Poland (34th place) and Romania (43rd place), but being still ahead of Russia (66th place) and Turkey (65th place).

The Executive Opinion Survey shows that business executives believe that in general Ukrainian women get the same level of salary as men (5.13 scores). Chernihiv, Chernivtsi and Khmelnytsky Oblasts are more inclined to give equal pay for equal work to men and women (5.45, 5.45 and 5.44 scores accordingly), whilst there is a wide gap between male and female salaries in Zaporizhzhya and Kharkiv Oblasts and in Kyiv City (4.66, 4.85 and 4.81 scores respectively). The sectors with the highest level of female employment have the narrowest gap: agriculture (5.68 scores) and hotels and restaurants business (5.41 scores). Meanwhile the gap gets wider in the heavy branches like construction (4.96 scores) and manufacturing industry (4.97 scores).

Business executives also often believe that they provide women and men with the same career opportunities. Odesa and Chernihiv Oblasts and well as the Autonomous Republic of Crimea create more equal opportunities for men and women (5.76 scores, 5.69 scores and 5.6 scores respectively), while Zaporizhzhya, Ternopil and Kyiv City provide less equal career opportunities (5.07, 5.12 and 5.22 scores). Financial sector ensures more equal gender conditions in banks (5.62), insurance companies (5.62) and investment companies (5.75 scores). Sectors which require physical work are characterized by wider gender disparities: manufacturing industry (4.94), electricity, gas and water production and distribution (5.29 scores). Mid-sized business incorporates gender equity in its work better (5.24 scores) compared with small business (4.99 scores).

### Hiring and firing practices

According to Hays Global Skills Index 2012 (by Hays company, in partnership with The Oxford Economics think-tank), Europe has faced a number of problems: declining and ageing skilled workforce and lack of staff with international experience or skills. Ukraine is not an exception as according to "Creating Jobs in a Global Economy", the report by Hays, Ukraine ranks 4th in the top 25 countries which will experience the sharpest fall in population of working age in the period between 2010 and 2030. Still, Ukraine is quite flexible in hiring and firing practices.

Thus, the firing and hiring practices are very flexible in Ivano-Frankivsk (4.68) and Luhansk (4.64 scores) Oblasts. In Chernihiv Oblast and city of Sevastopol the hiring and firing practices are more regulated by the state than by the employers (4.22 and 4.15 scores). In the branch comparison, the similar situation is in mining industry. It is obvious that the hiring and firing practices are more controlled by employers of small companies (4.39 scores), while medium and large companies deal with the legislation requirements (4.05 scores).

### Cooperation in labour-employer relations

Absence of conflicts between employees and employers has a direct impact on the labour productivity in the company and its competitiveness as an outcome. According to the Executive Opinion Survey, Kharkiv Oblast can boast of partnership in employee/employer relations (5.08 scores), while city of Sevastopol has rather conflict-ridden labour-employer relations (4.63 scores). The hotels and restaurants sector demonstrates good level of cooperation between employees and employers (5.18 scores), while conflicts are more common in the mining industry (4.50 scores).

### Flexibility of wage determination

Higher flexibility of wage determination makes companies more competitive in spite of the fact that it might infringe the interests of hired workers. In general, Ukrainian business is not restricted in this issue. In Kyiv City each company makes its own decision about the level of salary (5.52 scores), while in Luhansk Oblast wages and salaries depend on the industry payment scale (4.84 scores). In the trade firms (5.25 scores) and insurance companies (5.2 scores) wages and salaries are not regulated by legislation or trade unions and are rather defined for each individual case, in contrast to companies of electricity, gas and water production and distribution (3.21 scores).

### Skilled specialists search

If business can easily find specialists with the required qualifications on the local market, it will spend less for searching and training staff; therefore business' costs become lower thanks to inefficient work or incorrect decisions made by poorly-skilled staff. It is easy enough for business to find skilled specialists in Kyiv City (4.24 scores) and Kharkiv Oblast (4.26 scores); vice versa business executives have problems with finding staff in Kirovohrad (2.92) and Luhansk (3.11 scores) Oblasts. Due to oversupply of university graduates from various economic departments, insurance and investment companies as well as banks do not have problems with staff supply (4.12, 4.0, and 4.02 scores respectively). Companies in manufacturing (3.3 scores) and agriculture (3.45 scores) have much more problems when searching for proper professionals.

### Capacity to retain and attract talents

Talented staff from large industrial and scientific centres like Donetsk (3.13 scores), Kharkiv (3.10), Dnipropetrovsk (3.11), Kyiv (3.14 scores) are likely to stay working in native regions, not trying to find jobs in other countries or Ukrainian regions. However, this is not the case for many residents of agricultural Oblasts like Ternopil (2.41) and Ivano-Frankivsk (2.36 scores) who are searching for jobs in other places. Interestingly enough, the results of the Executive Opinion Survey for this indicator by regions are in terms with the classification of Ukrainian contemporary labour migration developed by the Institute of Demography and Social Studies of the National Academy of Sciences of Ukraine. By industry, workers of companies in the electricity, gas and water production and distribution sector are more likely to migrate (2.56 scores). Obviously, employees of large companies are the least interested in changing their native region or country (2.89 scores).

Business executives of Kyiv City (4.21 scores) note that many talented people come to the capital from other Ukrainian regions. On the contrary, Zaporizhzhya and Ternopil Oblasts are the least attractive (2.03 and 2.05 scores respectively). Noteworthy, agricultural workers as well as workers of mining and manufacturing industries are less inclined to change their workplaces (with 2.48, 2.54, and 2.6 scores).

Overall, the situation with searching, attracting and retaining skilled staff in Ukraine is aggravated by the fact that despite being interested in skilled staff businesses are not ready to pay competitive salaries and invest in staff improvements. It is no wonder, that valuable staff and talents might move to other companies, regions and even abroad.

## 3.6 Innovations

The intensive competition in the global market and available opportunities for business activities require active application of innovations, technological solutions and financial instruments, which can be characterized as so-called the hard factors of business sophistication. The Global Competitiveness Index considers them mostly in two competitiveness sub-indices: efficiency enhancers (mainly for efficiency-driven economies, the level that Ukraine's economy has recently achieved), and innovation and sophistication factors (for innovation-driven economies that should be the aim for any country including Ukraine).

**THE RESEARCH SHOWS THAT UKRAINE PERFORMS WORSE THAN IT COULD IN HARD FACTORS. THE FACT IS CONFIRMED WITH ITS LAG BEHIND PEERS AND EVEN BIGGER GAP FROM GLOBAL LEADERS**

Just five years ago, Ukraine's performance in innovations in the Global Competitiveness Index could be seen almost as a competitive advantage (52nd in the GCI 2008). However, GCI 2013, has moved Ukraine to 93rd place for this pillar, down 22 places during a year. This downturn is not typical for Ukraine's peers (post-Socialist and post-Soviet nations). As an example, Russia has risen by 7 positions over the last year, whilst Kazakhstan (having outperformed Ukraine) has risen by 19 places. As a result, the gap between Ukraine and its peers has widened significantly (15 places from Russia; 28 places from Poland and 56 places from the Czech Republic) and is likely to remain the same in the near future. However, many CIS and CEE countries have also only achieved smaller scores for innovation.

Other evaluations, independent from that of the WEF, have also confirmed Ukraine's low place in innovation factors. For example, Global Innovation Index 2013 (compiled by INSEAD business school, S. Johnson Graduate School of Management at Cornell University, and the World Intellectual Property Organization – WIPO) has placed Ukraine in 71st position out of 142, down 8 positions compared with 2012. Nevertheless, even with this score Ukraine is a leader amongst the medium-income nations. Yet another Global Innovation Index, compiled by Boston Consulting Group and the US National Association of Manufacturers, evaluates business capacity to encourage development of innovations. This organisation has placed Ukraine in 64th position out of 110 nations. The Global Innovation Quotient, published by Bloomberg and based on international data, ranks Ukraine 42nd out of 96 nations by innovations and only 69th by productivity.

Various organisations' rankings of Ukraine's innovations in economy and business do not see the country as a leader. Moreover, the indices evaluating the innovations in business

(those by WEF and by BCG) have not placed Ukraine in the top 50, meaning that the country does not have a competitive advantage in the global perspective.

An analysis of Ukraine's innovation in the GCI (Figure 3.13) suggests that the downward trend is largely caused by a drop in scores for qualitative indicators: capacity for innovation (100th out of 142, down 42 places), company spending on R&D (112th, down 8 places), university-industry collaboration (77th, down 8 places) and the quality of scientific research institutions (69th, down 5 places). Losing 21 positions, the indicator of availability of scientists and engineers has also dropped noticeably now to 46th place, yet it still can be seen as a competitive advantage. Ukraine performs relatively well in PCT patent applications (per capita) and takes 52nd place globally. Nonetheless, Ukraine continues to lose all of its competitive advantages in the innovation pillar of the Global Competitiveness Index.

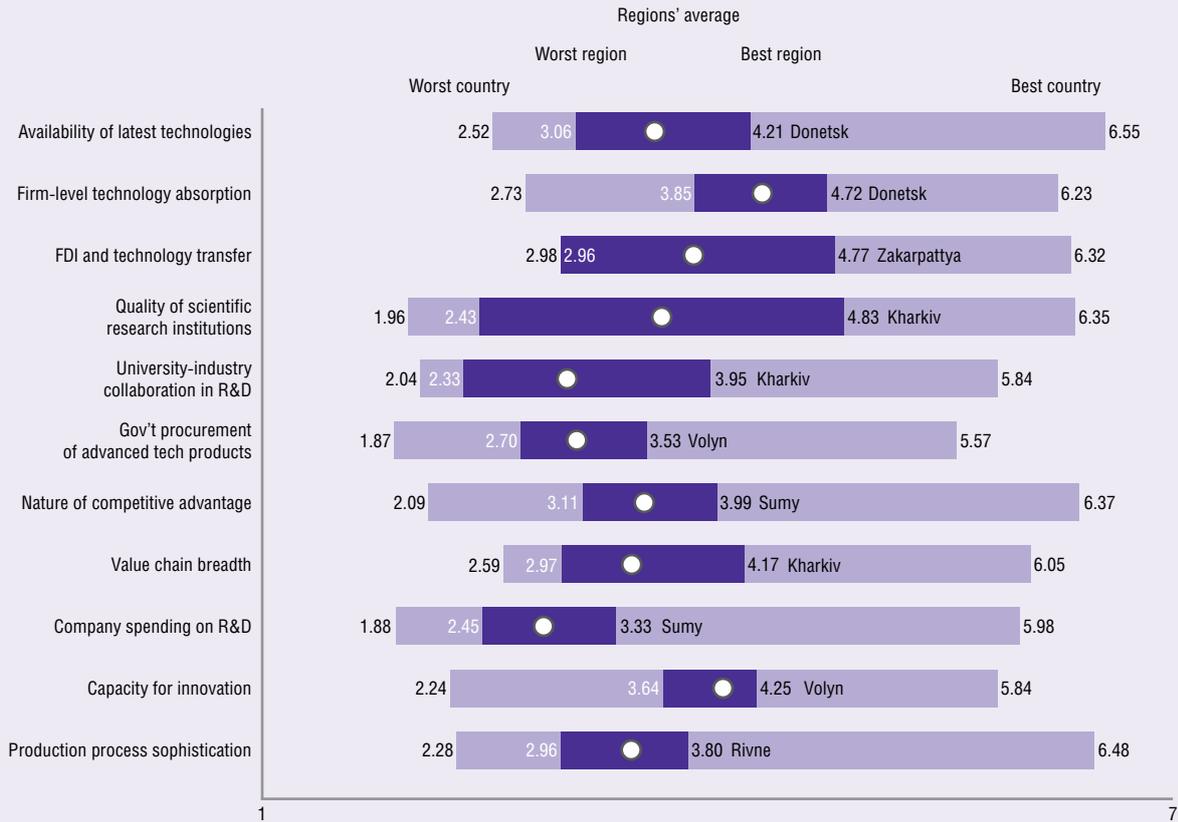
### ASSESSMENT OF INNOVATION ACTIVITY INDICATORS IN REGIONS

Executive Opinion Survey 2013 conducted by the Foundation for Effective Governance shows that businesses are still not ready to invest widely in the development of innovations in Ukraine, and lack advanced technology. The top managers' assessment of company spending on R&D and university-industry collaboration is low.

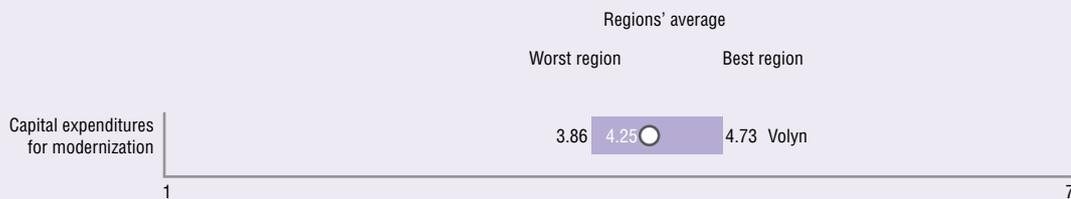
#### Innovation potential of business

The Survey conducted by the Foundation for Effective Governance in 2013 shows that the regional businesses look rather optimistically at the capacity for innovation. The average score across 27 regions is 4.03 scores, which is comparable with Azerbaijan (35th in the world). This relatively high result is partly due to the disposition of the regional business relying more on its own R&D than on adoption and purchasing such skills. The regional comparison gives the highest scores to Kyiv (4.24) and Volyn (4.25) Oblasts, while Zaporizhzhya (3.64) and Chernihiv (3.76) Oblasts' rank at the bottom. In terms of industries, the highest scores come from business executives in the financial sector, in insurance (4.29) and investment (4.42) companies, whilst the lowest is from top managers in mining industry (3.76), transport and communications (3.83 scores). Large companies naturally have higher capacity for innovation (4.19 scores) than small enterprises (3.95) but the gap is not that significant.

It is indicative that the executives assess business failures strongly and see them as valuable experience

**Figure 3.13A** Innovation scores of Ukrainian regions and global economies

Sources: World Economic Forum, *The Global Competitiveness Report, 2013*; Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

**Figure 3.13B** Modernization scores of Ukrainian regions

Sources: World Economic Forum, *The Global Competitiveness Report, 2013*; Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

rather than something disgraceful (average score of 5.07 out of 7). The firm-level technology absorption is evaluated highly too (4.29). Considering this with the reasonably good assessment of the capacity for innovation, it signals that the Ukrainian businesses have kept their innovation potential and can revive it if there is sufficient funding and favourable market conditions.

#### Availability of technologies and R&D spending

If businesses are not developing the latest technologies by themselves, because of certain reasons, they can still adopt them from others. The faster and easier it can be achieved, the faster they can adapt to changes in the market. Therefore, the more access a business can have to the latest technologies, the more competitive it is believed to be. Unlike with the capacity for innovation, the regional business executives on average give low scores to availability of the latest technologies: 3.58 scores, which is slightly above the Kyrgyz Republic (3.57) ranking 138th. The regional comparison shows that the

latest technologies are mostly available in large industrial areas – Donetsk (4.21) and Kharkiv (4.20 scores) Oblasts as well as in Kyiv City (3.99 scores). However some other Oblasts like Chernihiv (with 3.06) and Luhansk (with 3.14) receive the lowest scores. The largest gap in these values is 1.15, which corresponds to about 50 positions in the global index. Top managers of large businesses give the highest scores for the availability of the latest technologies (3.91 scores). From an industrial perspective, the strongest evaluations come from insurance (4.02) and investment (4.60) companies as well as from hotels and restaurants (4.14 scores). The mining industry (3.45) and the sector of production and distribution of electricity, gas and water (3.42) are given the worst assessment.

Businesses speak critically about company spending on R&D and give this indicator the lowest score compared with other dimensions of innovation – 2.85 on average across 27 regions. Only the leading ones can be compared with the global average value (3.3 scores), like Sumy (3.33)

and Kharkiv (3.26), which perform at the same level as Slovenia and Lithuania (3.2 and 3.1 scores, or 62nd and 63rd places respectively). These results are similar to scores for the spending on R&D in large companies, while SMEs score is far less scores. Business managers in Kyiv (2.45) and Luhansk (2.85) Oblasts give the lowest scores to their regions that correspond to the 138th place out of 148 nations (only Moldova and the Kyrgyz Republic from the post-Soviet countries rank lower). The executives believe that agriculture and trade spend the least on R&D, while processing industry as well as transport and communications spend the most.

### University-industry collaboration

Close cooperation of businesses with universities and R&D institutions make innovations very effective, from invention to final sales. The closer researchers and educators work with firms, the faster businesses get necessary technology, which eventually are relatively less expensive. University-industry collaboration in R&D for Ukraine's Oblasts demonstrates very poor scores. The average value across all 27 regions in Ukraine is 3.01 (corresponds to the level of Bulgaria at 117th place). Kharkiv (3.95), Donetsk (3.61) and Dnipropetrovsk (3.64) Oblasts assess the indicator higher, while Poltava (2.68), Volyn (2.68) and Chernihiv (2.34) show the smallest results. It means that the largest regional gap is 1.62 scores or 90 positions in the global index, as between Turkey (52nd; 3.9 scores) and

the Kyrgyz Republic (142nd; 2.2 scores). From the sectoral perspective, the best scores come from banks (3.32) and investment companies (3.57), while the worst are seen in trade (2.74) and manufacturing industry (2.97 scores).

Executive Opinion Survey 2013 shows that the quality of scientific research institutions on average in Ukraine receives 3.63 scores, with a large gap of 2.4 scores between the highest and lowest scores. The highest scores are registered in traditional R&D centres Kharkiv Oblast (4.83) and Kyiv City (4.44), which are comparable in the global ranking with Malaysia (4.88) or Spain (4.57), with 27th and 36th ranking respectively. Small agrarian Oblasts, such as Kirovohrad (2.84) and Zhytomyr (2.43) have given the poorest performance this year, approximately at the same level as Moldova (2.59, 13th ranking). In sectoral benchmarking, the businessmen in agriculture are given the lowest scores (3.0), whilst executives in the construction indicate relatively good performance (4.21 scores).

As global markets are getting more integrated and technologies are spreading quickly, innovations become a key driver of the economic growth and competitiveness of the national economies. To encourage effectively the development through innovations, countries need extensive cooperation of businesses, R&D institutions and universities as well as government in the context of preparation and adoption of innovations policies. The cooperation has developed slowly and inefficiently so far in Ukraine, this fact confirmed by the scores given in the GCI and the Executive Opinion Survey.

## 3.7 Internal business processes

In today's competitive market companies use innovations to improve their production processes and better the quality of business administration. It is very important to be able to manage a variety of business processes: planning, modelling, marketing and customers relations as well as communication with external consultants. Implementation of management information systems is vital to make all business processes transparent for executives and owners.

THE DEGREE OF BUSINESS PROCESS AUTOMATION INDICATES THE BUSINESS SOPHISTICATION LEVEL IN A COUNTRY OR REGION. HOWEVER, INTRODUCTION OF SUCH MANAGEMENT SYSTEMS IS COMPLEX AND EXPENSIVE WITH HARD-TO-MEASURE RESULTS.

For example, management information systems (MIS) are not widely used even in the European Union (Figure 3.14). Only half of all EU businesses use internal e-docflow (according to Eurostat data, 2012). The share of companies that apply more complex MIS is even smaller: only 22% use ERP (Enterprise Resource Planning); 23% use SCM (Supply Chain Management) and 26% use CRM (Customer Relationship Management) systems.

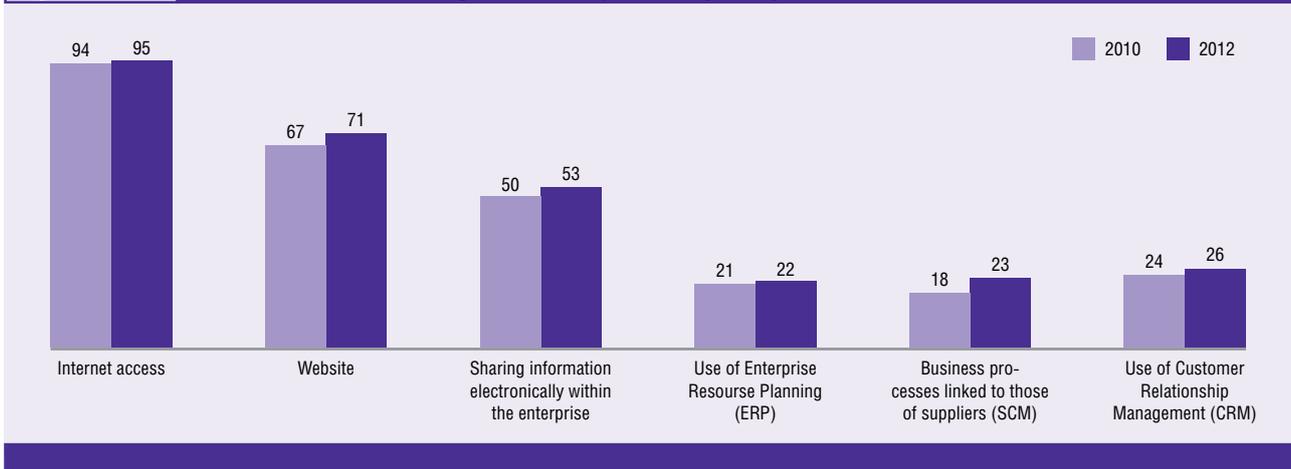
It is hard to estimate correctly level of MIS implementation in Ukraine due to lack of necessary statistics, although it is possible to get rough estimations based on various sales data by MIS suppliers. General trend is that the market has gradually recovered after the crisis-caused drop in sales; it added 33% in 2012 (according to IDC consultancy). Large corporations install systems developed by large international

producers (over a half of the market by aggregate sales), whilst SMEs rather use locally developed software either from Ukraine or from Russia. From the sectoral perspective, manufacturing and retail businesses are the major consumers of such systems in Ukraine, which provide 64% of sales of MIS solutions. At the same time, very large companies (with more than 1,000 employees) provided up to 58% of ERP sales in 2012 (that is three times more than a year before). According to the IDC estimates, the key manufacturing branches industry (steel and chemical production), transport and communications (mostly pipeline transport and post communications) as well as energy sector are going to show the fastest growth in ERP.

Along with automated systems, the compliance of corporate financial accounts with the international standards can influence the development of internal business processes as well. With 3.7 scores, Ukraine ranks 130th out of 148 nations by this indicator in Global Competitiveness Index 2013, which is the lowest score amidst all post-Soviet nations (e.g. Russia got 4.0 and 107th position, while Estonia got 5.5 scores and 26th position). In 2012, Ukraine went up from 133rd to 122nd place but failed to keep this position.

### ASSESSMENT OF BUSINESS PROCESSES IN REGIONS

Executive Opinion Survey 2013 conducted by the Foundation for Effective Governance shows how Ukrainian companies develop their internal business processes:

**Figure 3.14** Use of electronic technologies in EU-27 (% of companies)

Source: Eurostat, *E-business integration, Statistics in focus, 6/2013*.

introducing automated management solutions (including e-docflow, ERP, CRM, TQM etc.), marketing and sales management systems; applying new business models, business planning systems and engaging external consultants to address specific objectives.

The Survey shows that the executives give the lowest scores for engagement of external consultants (with regional average of 3.38 scores), introduction of international standards (ISO 9000, etc.) of quality management systems (3.52) and application of automated management solutions (3.53). Business planning is assessed fairly low too with an average score of 3.87, which shows that planning is guided by intuition and experience rather than by a comprehensive analysis and modern technology.

Business executives believe that Ukraine performs quite well in sharing information electronically (average score of 5.70) and care for customer needs (4.93). Large firms naturally assess business processes higher (4.54 on average) than medium-sized and small companies (almost equal scores of 4.18 and 4.17 respectively, see Figure 3.16).

From the sectoral perspective, the highest scores for the business process development come from the financial sector (banks (4.79), insurance (4.61) and investment (4.49) companies). The electricity, gas and water companies receive the lowest scores (3.94). The difference between regional scores is small, with the best figures in large industrial Oblasts such as Kharkiv (4.38), Dnipropetrovsk (4.34) and Donetsk (4.34) as well as in the cities of Kyiv (4.29) and Sevastopol (4.22). Within the Oblasts of Ternopil (4.05), Kirovohrad (4.04) and Zaporizhzhya (4.08) business processes are assessed much lower than in other Oblasts.

### Management information systems

Implementation of automated management solutions optimises and integrates all business processes in an organisation and establish an agile and efficient system for inter-departmental interaction and external partner engagement. The Executive Opinion Survey shows that on average the Ukrainians regions automate management processes rather reluctantly (3.53 scores). Merely 8% of companies have all of their operations fully automated (assessing maximum scores of 7). Other 13% have them almost fully automated (6 scores), that is comparable with average numbers across of the EU. As expected, large

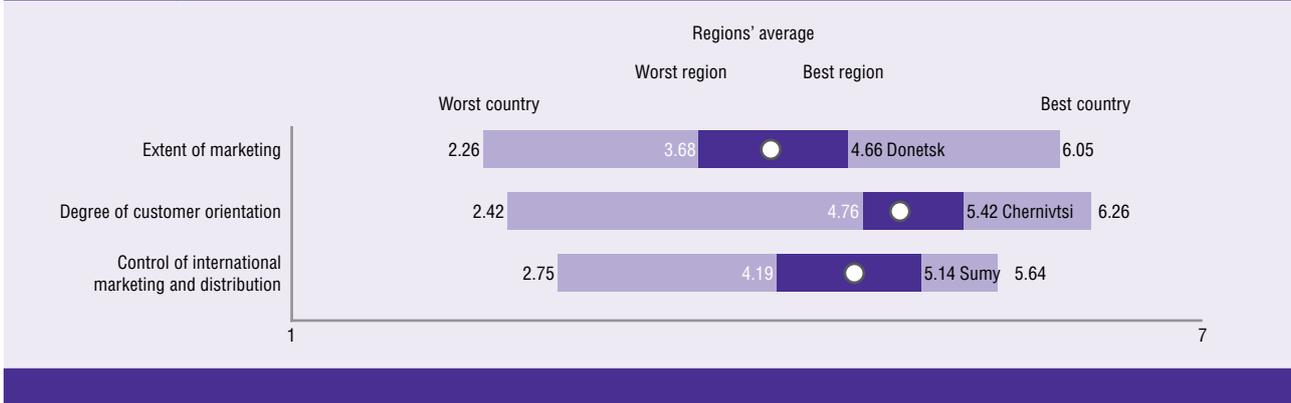
companies give higher scores (4.22) than small (3.53) and medium-sized (3.37) enterprises. However, only 6% of large companies have fully automated operations, while only 5% for medium-sized businesses and 10% for small businesses did that. Financial sector (banks, insurance and investment companies) assign the highest scores for MIS. Producers and distributors of electricity, gas and water as well as construction firms give the lowest scores (2.96 and 3.04 respectively). The breakdown by region demonstrates that the large industrial Oblasts of Dnipropetrovsk (3.92) and Kharkiv (3.84) as well Sevastopol City (3.98) perform the best, while Chernivtsi (3.11) and Vinnytsya (2.99) Oblasts receive the lowest scores.

Introduction of e-document flow management is an important indicator, which is fairly strong (5.7) across the Oblasts, unlike the automated management solutions. In fact, 28% of respondents apply e-docflow across the board, using specialised solutions (maximum score of 7). Other 35% of companies apply it widely (6 out of 7 scores). The specific indicator of application of e-docflow management in Ukrainian regions is thus higher on average than in EU-27 and corresponds to the level of developed nations (e.g., Nordic countries like Denmark or Sweden). The breadth of its use does not depend much on the business size, however small companies have a slightly higher average score (5.75). The breakdown by industry is similar to that of MIS: the financial sector (6.25 scores for banks and 6.18 for insurance companies) has the best scores, while the worst are observed in agriculture (5.53) as well as hotels and restaurants sector (5.62 scores).

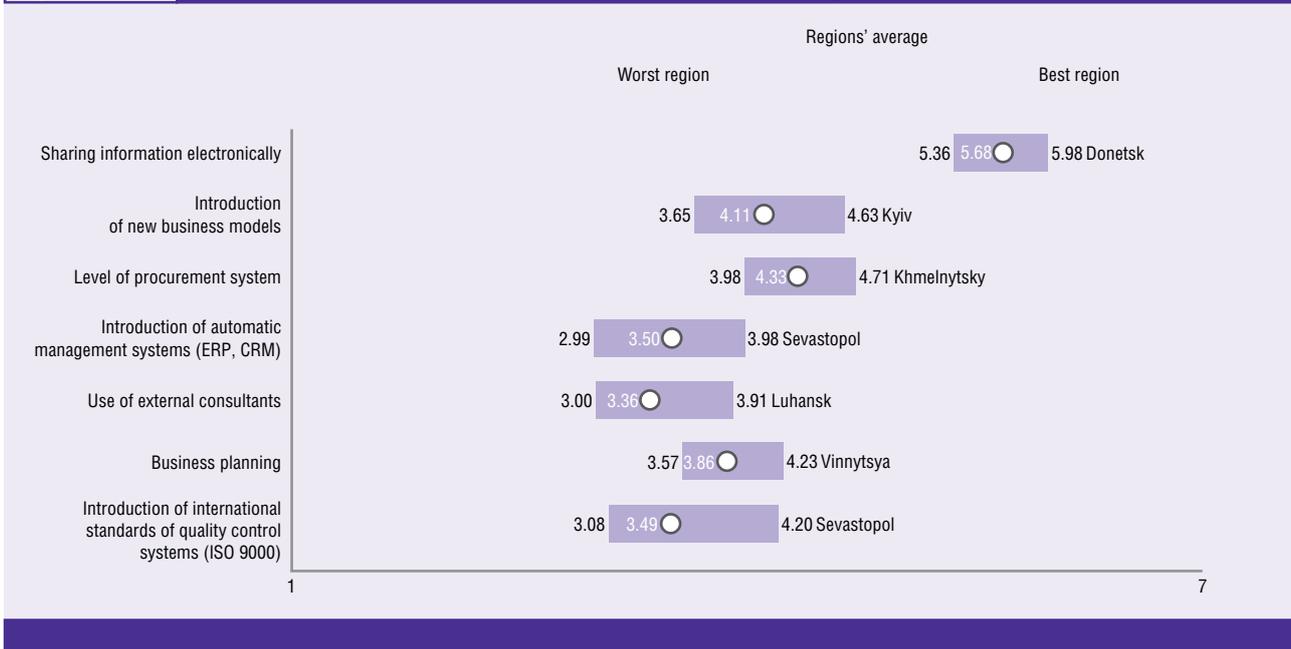
### Marketing and quality management

Estimating marketing issues, Executive Opinion Survey 2013 considered both the effectiveness of marketing in general and customer relations in particular. The attitude of companies to total quality management was also part of a special focus.

On average, the level of marketing in Ukraine's regions is comparable with the average value of the GCI: 4.08 compared with 4.16 scores. This means that many Ukrainian companies apply marketing principles; although it does not necessary mean that they use the most advanced techniques. The extent of marketing does not necessarily depend on the size of the business, although the scores of large companies are in general better. At the same time,

**Figure 3.15A** Development of internal business processes in Ukrainian regions and global economies.

Source: World Economic Forum, *The Global Competitiveness Report, 2013*; Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

**Figure 3.15B** Assessment of some internal business process in Ukrainian regions.

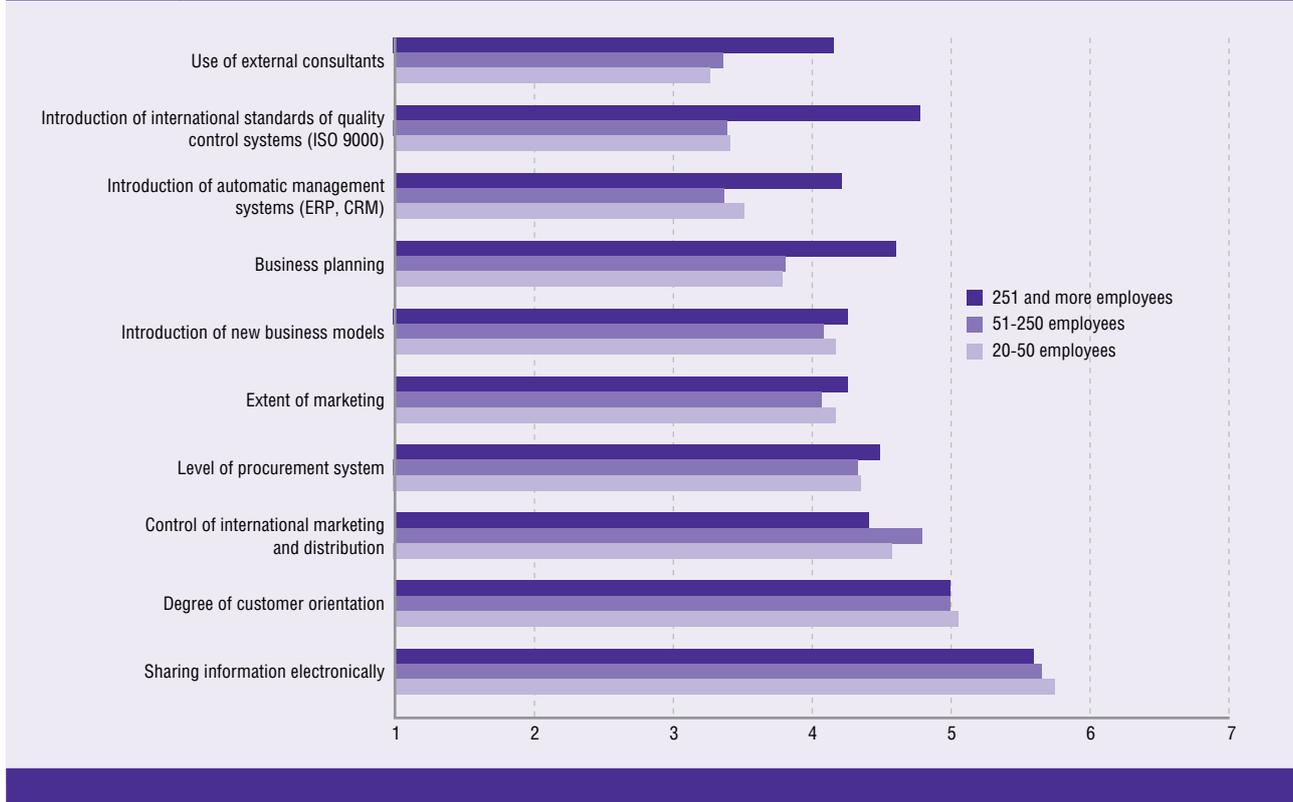
Source: Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

within different branches, the difference is more evident: marketing is more developed in banks (4.60), hotels and restaurants (4.57 scores) and less in the resource-based branches, like mining industry (3.94), production and distribution of electricity, gas and water (3.93), and agriculture (3.79). The regional gap is even wider, up to 1 score. Mykolayiv (3.68), Chernihiv (3.74), Zakarpattya (3.81) have the lowest scores, whilst the three largest industrial regions of Donetsk (4.66), Kyiv City (4.46) and Dnipropetrovsk (4.42) are top performers.

Establishing customer relations is an important part of marketing management. Making such relations automated (via CRM systems) is one of key solutions in MIS. The Survey shows that business executives assess the engagement with customers as truly high, giving 4.93 scores on average across Ukraine's regions. Small businesses give a higher score than medium or large companies. The manufacturing industry (5.15 scores) and hotels and restaurants (5.52) assign the highest scores for customer relations, whereas executives of banks and companies of the transport and communications sectors give the lowest assessment (by 4.94 both). Amid Oblasts, the worst scores for customer relations are seen in Volyn (4.76), Zaporizhzhya (4.77),

Kirovohrad (4.81), whilst the best are in Chernivtsi (5.42), Zhytomyr (5.17) and Rivne (5.11).

Business executives assess the level of introduction and application of international total quality management (TQM) standards (e.g. ISO 9000) quite moderately, with 3.52 scores on average. Only 13% of the respondents indicate that business processes in their companies are fully certified (7 scores); 12% of them, almost fully certified (6 scores). Large companies are well ahead (4.78) of small and medium-sized businesses (3.42 and 3.39 respectively). It is indicative that 30% of large companies have fully certified business processes, while the SME segment has only 12% share. The industrial breakdown is dominated by financial sector, where many processes must be certified (5.17 scores for banks and 4.23 for insurance companies). The resource-based industries give extremely low scores: agriculture (2.87) as well as production and distribution of electricity, gas and water (2.72). Mykolayiv (3.08 scores), Chernivtsi (3.16) and Volyn (3.17) Oblasts have the worse level of penetration of international quality management standards in regards to other regions. Sevastopol City (4.20), Dnipropetrovsk (3.92) and Luhansk (3.82) Oblasts receive the highest scores.

**Figure 3.16** Assessment of business processes development by company size

Source: Foundation for Effective Governance, Executive Opinion Survey, 2013.

### Business planning and modelling

Results of Executive Opinion Survey 2013 suggest that business planning in Ukrainian companies is based on intuition and experience of the chief executives rather than on a complex analysis involving the use of modern technologies. The average regional score of this indicator is 3.87 (out of 7). Merely 9% of respondents said that business planning in their companies is based on a complex analysis and contemporary techniques (maximum score of 7); yet a third of executives give 6 scores. Large businesses have better scores, with two fifths of them (41%) arguing they use contemporary techniques and systematic approaches for planning. The average score for the indicator in large companies is 4.61, much higher than the performance of medium-sized businesses (3.81; 30% give 6 or 7) and small businesses (3.80; 28% give 6 or 7 scores). The industrial gap is very large – up to three scores: financial sector attract the top scores (5.83 in banks and 4.90 in insurance companies), while construction demonstrates the lowest scores (2.98). Unlike the differences in scores by industries or size, the regional differences are not that large. Lviv (3.57) and Kherson (3.64) give the lowest scores, while Chernihiv (4.10) and Vinnytsya (4.23) perform slightly better.

The Executive Opinion Survey also evaluates how quickly the companies are introducing new business models. The average regional score (4.15) exceeds the global average (4.04), while the average score of large companies is even higher (4.27). The champions in introduction of new business models are hotels and restaurants (4.70) as well as the financial sector (investment (4.50) and insurance (4.46) companies). The lowest scores are in the resource-based industries: mining (3.70), agriculture (3.82), production and distribution of electricity, gas and water (3.91). Alike

the industries, the gap between the Oblasts is about 1 score as well. Urbanized industrial Oblasts of Donetsk (4.51) and Kharkiv (4.43) along with Kyiv city (4.63) receive the highest scores; meantime Luhansk (3.65) and Chernihiv (3.70) have the lowest assessment.

The companies cannot often cope by themselves with challenging or newly emergent objectives in IT, marketing and consulting and thus engage external consultants. It is indicative that only 5% of respondents said they engaged external consultants regularly and continuously, giving the maximum of 7 scores. Another 16% of companies engaged consultants fairly often (6 scores). Working with external consultants is obviously more typical for large businesses (4.16) than small ones (3.27). More than a half (51%) of large business executives say they engage external consultants more often and more intensively than on average in Ukraine (5 out of 7 scores), while the same shares of SMEs are just above one-third. These services are mostly demanded in finance (insurance companies (4.52) and banks (4.39)), being least needed for construction (2.89) and production and distribution of electricity, gas and water sector (2.96 scores).

Such low scores, assessed by top manager in Ukraine's regions, are clearly understandable if one takes into account the fact that introducing MIS solutions, international business standards and new business models normally requires professional external consultants, but that is not the case for most Ukrainian companies. A few exceptions can include e-document flow (relatively affordable for businesses) as well as marketing and customer relations (needed for sustainable sales).

## 3.8 Financing

### LOW LEVEL OF FINANCIAL MARKET UNDERMINES COMPETITIVENESS

A decline in the overall growth rate of the Ukraine's economy is mostly due to the lack of financial resources which can be seen from the slowdown in investments. In the context of a credit crunch the companies have to increase their issuance of securities to raise capital, but they face restricted opportunities due to the small volume of Ukraine's equity market. Additionally, in Ukraine there is a wide regional and industrial disparity in terms of opportunities for business financing.

The World Economic Forum provides a comparable analysis of financial problems in The Financial Development Report. Ukraine occupies low positions almost across all pillars within the Financial Development Index 2012 calculated on the basis of this survey.

THE DIFFICULT SITUATION WITH FINANCING CAN BE EXPLAINED BY THE IMPLICATIONS OF THE FINANCIAL CRISIS. HOWEVER, LOW LEVEL OF FINANCIAL MARKET DEVELOPMENT IN UKRAINE IS ALSO AN IMPORTANT FACTOR AS SOME DIMENSIONS OF THE FINANCIAL PILLAR HAVE DETERIORATED OVER THE LAST YEARS

The country ranks very low in such indicators as financial access, ease of access to loans (51st out of 62), venture capital availability (54th), ease of access to credit (59th), financing through local equity market (61st) with the scores ranging between 2.2 and 2.4 (on a scale from 1 to 7; Table 3.3.A). As a result, Ukraine falls behind their peer countries on financial market development (Table 3.3.B).

The key WEF's survey, Global Competitiveness Index, does not provide an in-depth analysis of the financial markets and corporate finances however it does cover a wide range of countries. As seen from Fig. 3.17, over the last year Ukraine's performance has deteriorated in almost all dimensions characterizing its financial market development and ability to raise investment. The country has lost its positions in the global ranking which means it has lost out in global competitiveness. The country has also received lower scores (except for the scores for financial services) which means losing pace in financial market development. The findings of the Ukrainian National Competitiveness Index show that in many of the Ukrainian Oblasts the situation is even worse than in Ukraine in general (Figure 3.18.).

### ASSESSMENT OF FINANCIAL MARKET DEVELOPMENT AND INVESTMENTS IN REGIONS

#### Financial services

The Executive Opinion Survey studies the assessment of availability and affordability of financial services. The business executives were asked to assess the range of financial products to identify their availability. Also the prices for these products were assessed, considering the competition between the financial market participants to

Index / pillars	Place (out of 62)	Score (out of 7)
<b>Financial Development Index</b>	<b>59</b>	<b>2.56</b>
Institutional environment	60	2.93
Business environment	52	3.57
Financial stability	60	3.14
Banking financial services	59	2.30
Non-banking financial services	34	1.95
Financial markets	53	1.40
Financial access	56	2.66

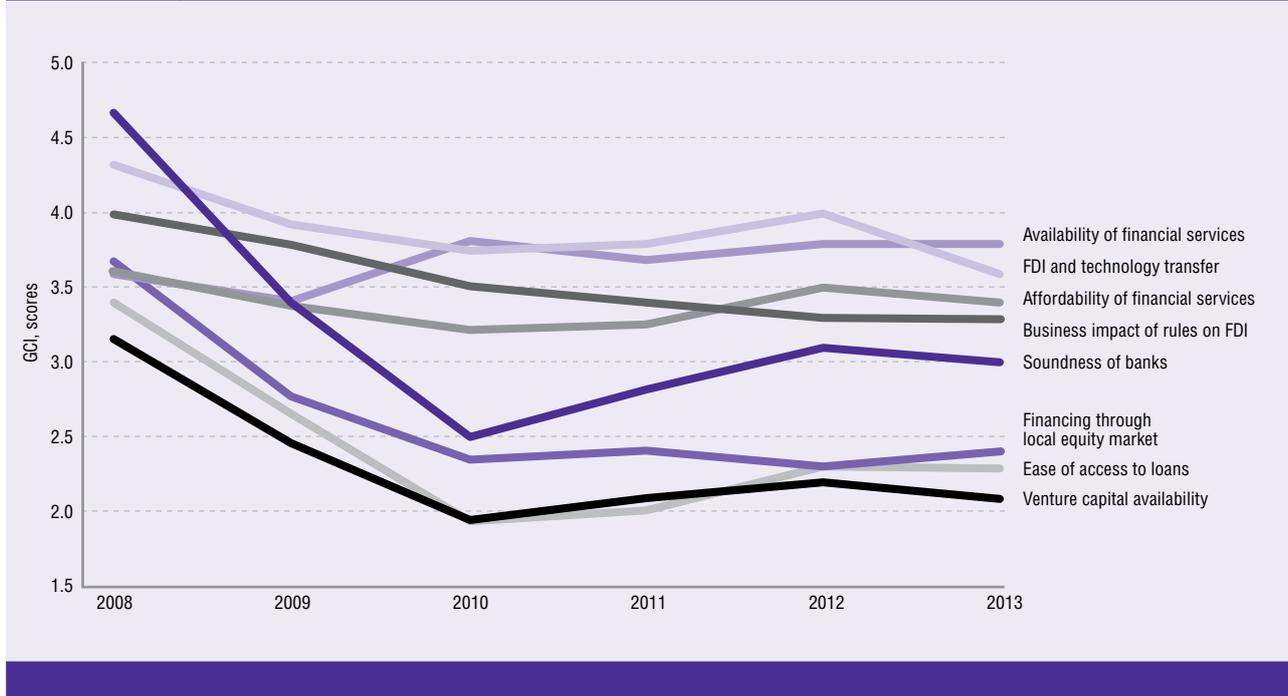
Source: World Economic Forum, The Financial Development Report, 2012.

Place	Country	Score
37	Poland	3.41
38	Slovak Republic	3.34
39	Russia	3.30
44	Hungary	3.16
47	Kazakhstan	3.13
51	Romania	2.93
<b>59</b>	<b>Ukraine</b>	<b>2.56</b>

Source: World Economic Forum, The Financial Development Report, 2012.

identify the level of affordability of financial services. The Ukrainian Oblasts show quite an even performance on availability of financial services with a difference of only 1 score between the worst-performing (Vinnitsya (4.60 scores) and Chernivtsi (4.75)) and the best performing Oblasts of Dnipropetrovsk (5.17), Rivne (5.18) and Kharkiv (5.26). Two of the top Oblasts give the largest value added contribution to the financial activity of the aggregate GDP of Ukraine, with 9.9% and 11.3% respectively (by 2011 data), whilst availability of financial services in these Oblasts ranks the same as that of Turkey, placed 28th globally. The average score for Kyiv City, the largest value added contributor to financial activity (36.2%), is 5.07, which corresponds to the same level as Latvia (47th). This can be partially explained by the high concentration of large and mid-sized businesses in the capital which are more critical in selecting financial services and give lower assessment (4.89 and 4.94 respectively) compared with small business (5.04 scores). The same situation is observed in Donetsk Oblast where there is a concentration of large business sites: despite a high value added contribution in financial activity (8.9%) the scores for availability of financial services are close to the average (5.16, similar to Estonia, 38th place). When reviewing industry, mining companies (4.06), hotels and restaurants business (4.48) and agricultural companies (4.53) receive the lowest scores on availability of financial services. The best performing companies are in the financial sector: investment and insurance companies (5.42 and 5.44 respectively) and banks (6.04).

Oblasts show quite an uneven performance in affordability of financial services. Kharkiv as well as Kyiv

**Figure 3.17** Dynamics of indicators of financial market development and investments of Ukraine in GCI

Source: World Economic Forum, *The Global Competitiveness Report, 2008-2013*.

and Sumy Oblasts are well ahead of the others (4.64, 4.64, and 4.68; can be compared with the Slovak Rep., ranking 37th globally). Among the outsiders there are Luhansk (4.01), Vinnytsya (4.14), Mykolayiv (4.15) Oblasts, with scores of the same level as Macedonia's (84th globally). Business executives of mid-sized businesses and some representatives of the larger business show the biggest dissatisfaction with the tariffs (4.15 and 4.20 respectively), while small businesses give the best assessment of affordability of financial services on average (4.44) due to the access to special offers. The industrial disparity relating to affordability of financial services is also observed with availability of these financial services. The resourced-based companies have the lowest scores: mining industry (3.55) and agriculture (4.03). Insurance companies, (4.82), banks (5.46) and hotels and restaurants (4.52) gain the highest scores.

### Banks and crediting

In respect to production technologies and capacities, business development requires injections of financial resources, which will not immediately bring financial benefits. The opportunity to get access to loans ultimately improves business flexibility and its competitiveness. Ease of access to loans is poorly assessed in Mykolayiv (2.31) and Vinnytsya (2.51) Oblasts (at a level between Moldova (104th) and Latvia (96th), and also in the capital city of Kyiv (2.54). Western Oblasts of Ternopil (3.01), Rivne (3.09), and Lviv (3.09) perform slightly better, but their scores are still low (at the same level as Bulgaria, 39th globally). If reviewed by sector, executives of mining companies (2.43) as well as executives of companies operating in financial sector give the lowest assessment for the ease of access to loans: investment companies (2.42) and insurance companies (2.43), placed 100th globally. The best results are observed with companies in the electricity, gas and water sector (3.32) and in hotels and restaurants business (3.50).

The Oblasts which receive a first-rate assessment for their soundness of banks include Khmelnytsky (5.18 scores), Chernihiv (5.14) and Volyn (5.02) Oblasts, which rank similarly as Poland (54th in globally). The worst performing Oblasts are Kirovohrad (4.42 scores) and Ivano-Frankivsk (4.44) as well as the capital city of Kyiv (4.51), with results worse than the rank of Kazakhstan (100th). If taken by sector, namely companies operating in the financial sector give the worst assessment of soundness of banks: investment (4.0) and insurance (4.37) companies, whilst executives of agricultural companies (5.0) and the banks themselves (5.58 scores) are more satisfied with this indicator and respectively.

### Equity and venture capital markets

In addition to standard scheme for obtaining loans, companies have been using globally two other important sources for raising capital: equity market and venture capital financing.

**PRIVATE INVESTORS OFTEN INVEST VENTURE CAPITAL IN NEW AND OFTEN INNOVATIVE BUSINESS, IN CONTRAST TO THE STANDARD STOCK MARKET, AS THEY ARE READY TO TAKE ADDITIONAL RISKS IN ORDER TO GAIN HIGHER PROFITS**

The Oblasts that scoring lowest in financing through local equity market indicator include Kirovohrad and Mykolayiv Oblasts (2.52 and 2.58 scores accordingly). Donetsk and Dnipropetrovsk Oblasts have the highest scores in this indicator (3.08 and 3.12 respectively, at the same level as Russia, 90th globally). Amongst the best performers there is also AR Crimea (3.03 scores). Business executives of electricity, gas and water sector companies and agricultural firms are more sceptical about the possibilities of the equity market (2.39 scores in both sectors). Business executives of banks and investment companies who are

**Figure 3.18** Assessment of financial market development and investment indicators for Ukrainian regions and global economies

Sources: World Economic Forum, *The Global Competitiveness Report, 2013*; Foundation for Effective Governance, *Executive Opinion Survey, 2013*.

directly engaged in stock market activity and thus feel more optimistic (3.15 and 3.27 respectively).

Business executives within the processing and mining sectors believe they have very limited venture capital availability (2.07 and 2.10). At the same time executives of investment and insurance companies as well as hotels and restaurants business give high assessment of venture capital availability (2.44, 2.49 and 2.68 respectively). Mykolayiv and Sumy Oblasts experience the largest difficulties with venture capital availability (1.96 and 1.90 scores each, approximately 131st – 133rd place globally, at the same level as Bosnia and Herzegovina, and the Kyrgyz Rep.). There is other Oblasts with restricted venture capital availability, like Ivano-Frankivsk (2.01).

Oblasts of Zhytomyr (2.36), Volyn (2.36) and Zaporizhzhya (2.39) receive relatively high assessment in this indicator (similar to the level as Romania (92nd) or Armenia (93rd)). However it is worth noting that in the regions, which develop innovation projects with venture capital, the scores in general are either above average or just close to average, for instance, in Kharkiv (2.17), Lviv (2.33), Dnipropetrovsk (2.33) Oblasts and in Kyiv City (2.28). Such results correspond to similar levels of Georgia (106th) or Croatia (110th).

The opinion of Ukrainian business executives coincides with the international assessment of Ukraine's attractiveness for venture investing. According to Global Venture Capital and Private Equity Country Attractiveness Index 2013 (compiled by IESE Business School with EY), Ukraine is in the second half of the rankings (69th out of 118 nations), between Croatia (65th) and Georgia (72nd), and falling down five positions during a year. Most peer countries, first of all Poland (28th) and Russia (40th), are more attractive to venture investors than Ukraine.

### Foreign direct investments

The highest negative regulation impact on FDI is observed in Cherkasy (3.66) and Ivano-Frankivsk (3.82) Oblasts and in Kyiv City (3.77), with the scores at the

same level as Bulgaria (118th) and Russia (121st). The best performers in this indicator are Volyn (4.52) and Sumy (4.80) with the results equal to the positions of Georgia and Turkey (49th and 50th globally). The sectors with the lowest scores include the trade area, where recently a number of major foreign investors have left the Ukrainian market, and investment companies (3.73) which often act as mediators between foreign investors and local companies. Business executives of hotels and restaurants business (4.35), transportation and communication services (4.37) and mining (4.62) give highest assessments for this indicator that can be explained by additional industry regulation in these branches.

The FDI inflows to Ukraine do not often bring new technologies. That is why business executives of large companies give a high assessment of FDI and technology transfer (4.17), whilst the assessment by medium companies' executives corresponds to the national average (3.70). If taken by sector, among the leaders are transportation and communications sector (3.92), mining industry (3.93) and financial sector (4.14 for banks, 4.09 for insurance companies and 4.73 for investment companies). The Oblasts of Zaporizhzhya (2.96), Luhansk (3.37) and Kirovohrad (3.23) show the most negative assessment for FDI and technology transfer (similar to the bottom of the global ranking of 148th place), while some Western regions, Ivano-Frankivsk (4.39) and Zakarpattya (4.77) receive the most positive assessment of this dimension, similar to that of Kazakhstan (93rd). Ukraine's centres of investment and innovation of Ukraine are slightly behind them, for instance, Kyiv City and Donetsk Oblasts have 4.36 and 4.10 respectively; that is the level of Bulgaria (107th) and Moldova (109th).

According to the Survey the poorly developed financial market and unfavourable investment climate make Ukraine unattractive for foreign investors. Ukraine is not even included in the Foreign Direct Investment Confidence Index (compiled by A.T. Kearney), whilst its

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neighbours perform reasonably well (Russia ranks 12th and Poland 23rd in Index 2012). Kyiv City is not in the list of Global Financial Centres Index (maintained by Z/Yen Group) although this Index does include Warsaw, Moscow, Saint-Petersburg, Tallinn and Budapest. In addition, in contrast to Poland, Russia and Hungary Ukraine is not included into the MSCI stock indices' set since Ukraine is classified as a "frontier market", and that is also amid the reasons why there is a lack of investors' interest.

On the other hand, Ukraine is assessed highly in terms of potential for raising investment. In the FDI Attraction Index vs FDI Potential Index Matrix 2011 (maintained by UNCTAD) Ukraine is "in line with expectations", the same as Poland, Russia and Kazakhstan. Thus, Ukraine has very good investment potential but it still fails to generate a real investment flow. As a result of the relatively low level of FDI, restricted availability and affordability of financial services, Ukrainian businesses experience problems with access to financing which is so much needed for business development in the context of an ever growing global competitive market.

## CONCLUSIONS

The study of business sophistication factors carried out within the framework of the Ukrainian National Competitiveness Index 2013 shows that low business development is a key constraint for improving Ukraine's competitiveness. In addition, the country continues to suffer from the existing problems relating to poor institutional framework, deterioration in the number of macroeconomic sub-pillars and the loss of positions in some education and infrastructure dimensions, where the performance depends on, to a greater extent, the government role.

In most cases, in terms of business sophistication, the Ukrainian business falls behind not only the leaders of the Global Competitiveness Index but also most other peer countries, the former Socialist countries and Soviet republics. Significant risks also arise as a result of a wide disparity within the business sophistication assessments. This happens also due to wide regional disparities (as a rule, large industrial and urban regions perform better), industrial disparities (often the situation is worse in resource-based sectors such as agriculture, electricity, gas and water sector, and mining industry) and sometimes as a result of differences depending on the size of the business (large businesses usually perform better in many indicators thanks to availability of significant resources, although sometimes small business perform better due to more flexibility). Subsequently, the existing differences in business sophistication can strengthen the disparities between the regions and industries.

Ukrainian businesses are not managed well; this can be seen from the assessment of efficacy of corporate boards, reliance on professional management and implementation of management information systems in companies. Often enough Ukrainian businesses fail to give proper attention to strategic development prospects, that is confirmed by the low scores in business planning and engagement of consultants. In the soft factors group, there is a disregard of corporate social responsibility, reputation management and capacity to retain talent. At the same time, a number of tactic objectives, especially those relating to marketing and customer relations, are solved quite well.

It is important to underline, that Ukrainian businesses become less innovative. There are very few regions with significant innovation development practices, while the overall situation in the country has become really critical over recent years. The regions and the country in whole keep on losing their positions in venture capital availability. The deterioration in the business innovation efficiency has become a long-term trend. In addition, Ukrainian businesses face restricted access to finances as a result of the low level of financial market development, in spite of the fact that the national financial sector is one of the most developed branches compared with other industries of the national economy.

The situation is getting really dramatic in the context of tight economic integration of Ukraine (joining the WTO, setting up the Free Trade Areas with the CIS, the EU and a number of particular countries). Nevertheless, further integration of Ukrainian economy can help businesses to improve their business processes and hence make national business more civilized. As the Survey shows some Ukrainian regions and sectors are quite competitive globally by certain indicators of business sophistication. If all the regions and industries improve their positions to the level of the leaders, that will lead to significant improvement of Ukraine's national competitiveness.

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LOW LEVEL OF UKRAINIAN BUSINESS DEVELOPMENT AND ITS WEAK ABILITY TO ADAPT TO NEW CHANGING CONDITIONS CAUSED BY GLOBALIZATION ARE THE KEY REASONS FOR LOW ASSESSMENT OF COMPETITIVENESS OF UKRAINIAN REGIONS AND THE COUNTRY IN WHOLE

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## Table 3.4. Regions' positions by business sophistication indicators and additional questions

UKRAINIAN NATIONAL COMPETITIVENESS INDEX		
Adaptability	9.01	Availability of latest technologies
	9.02	Firm-level technology absorption
	11.07	Production process sophistication
	addl. question	How do you evaluate your company's ability to adapt to external shocks? (crisis, changes in the legislation)? For the last 5 years how did expenses on modernisation of fixed assets change in your company?
Corporate governance	1.19	Efficacy of corporate boards
	1.20	Protection of minority shareholders' interests
	1.21	Strength of investor protection
	6.02	Extent of market dominance
	7.07	Reliance on professional management
	8.07	Regulation of securities exchanges
	11.09	Willingness to delegate authority
Corporate ethics	1.03	Diversion of public funds
	1.05	Irregular payments and bribes
	1.06	Judicial independence
	1.17	Ethical behavior of firms
	addl. question	During last 5 years how often did your business partners/contractors not fulfill their commitments? How is reputation important for your business?
Corporate social responsibility		Does your company spend money on social events? (not at all / significant amounts on a regular basis)
	addl. question	a. Internal projects: social programs for employees b. Spatial development projects (in a town or area of business presence): infrastructure, ecology c. Community development projects: health and sport, education and culture, social care
Human resources	5.07	Local availability of specialized research and training services
	5.08	Extent of staff training
	7.01	Cooperation in labor-employer relations
	7.02	Flexibility of wage determination
	7.03	Hiring and firing practices
	7.06	Pay and productivity
	7.08	Country capacity to retain talent
	7.09	Country capacity to attract talent
	7.10	Female participation in labor force, ratio to men
	12.06	Availability of scientists and engineers
		In your region are women's salaries similar to the salaries of men performing the same job?
	addl. question	To what extent do business in your area provides women the same opportunities as men to move up the career ladder? Motivation system in your company (limited by material remuneration only / contains various non-financial incentives)? In your region is it easy to find the necessary specialists to business?
	Innovations	11.04
11.05		Value chain breadth
12.01		Capacity for innovation
12.02		Quality of scientific research institutions
12.03		Company spending on R&D
12.04		University-industry collaboration in R&D
12.05		Government procurement of advanced technology products
Internal business processes	11.06	Control of international distribution
		How active are companies in your region in the implementation of new business models, organizational structures etc.?
		How developed system of procurement have businesses in your region (risk management, quality standards, etc.)?
	addl. question	How widely is e-document flow used in your company? Your company has implemented and is currently using automatic control systems, such as – ERP, CRM and so on? Business planning in your company (based on own intuition and experience / complex analysis using modern technologies)? Your company has implemented and is currently using international standards of quality control (for example, ISO 9000)? Your company attracts external consultants for its operations (such as strategy, marketing, IT)?
Financing	6.12	Business impact of rules on FDI
	8.01	Availability of financial services
	8.02	Affordability of financial services
	8.03	Financing through local equity market
	8.04	Ease of access to loans
	8.05	Venture capital availability
	8.06	Soundness of banks
	9.03	FDI and technology transfer

	Kyiv	Kharkiv	Odesa	Donetsk	Dnipropetrovsk	Lviv	KyivOblast	Zaporizhzhya	Poltava	Sevastopol	AR Crimea	Rivne	Khmelnytsky	Sumy	Ivano-Frankivsk	Vinnitsya	Volyn	Cherkasy	Mykolayiv	Zakarpattia	Luhansk	Chernivtsi	Chernihiv	Terнопil	Zhytomyr	Kherson	Kirovohrad
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