

# Suitable business concepts for Ukraine

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# Ukraine country snapshot



## Geography and population

- Area: 603,700 km<sup>2</sup>
- Borders 7 countries, of which 4 are EU members
- Aging and decreasing population, split unevenly -46.4m (*1/3 of Russia*)
  - Concentrated in industrialized cities of the East
- Almost 70% urban
- Significant geographic income differences (Kyiv \$320 average monthly wage; East \$205; West \$173)
- 12% of population have a university degree
- Languages: Ukrainian (official), Russian (widely spoken, esp. in the East)
- Religion: mostly various forms of Christianity (small Jewish and Muslim communities)

## Economics

- GDP: \$100 bn (about 1/12 of Russia)
- GDP per capita: \$2,150 (about ¼ of Russia)
- World Bank business environment ranking 2007: 139 (*Russia: 106*)
- World Leader in the production on barley and coarse grain, primary products, iron and steel
- Heavy exporter of iron and steel

## Politics

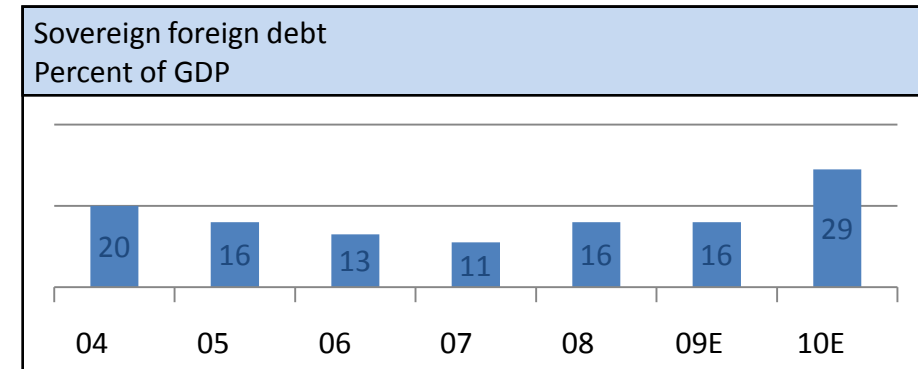
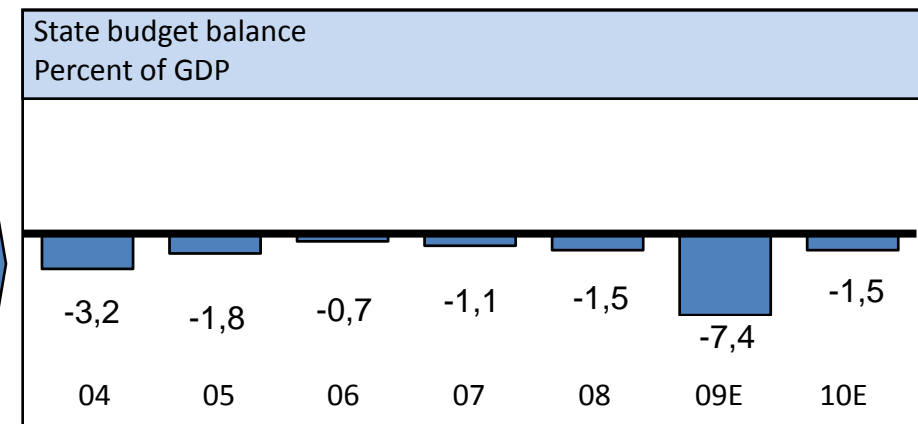
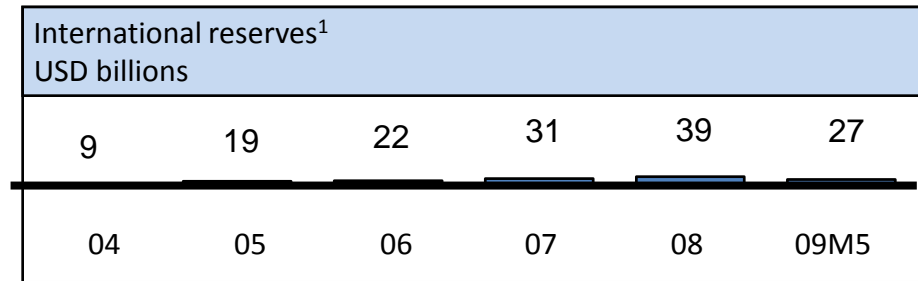
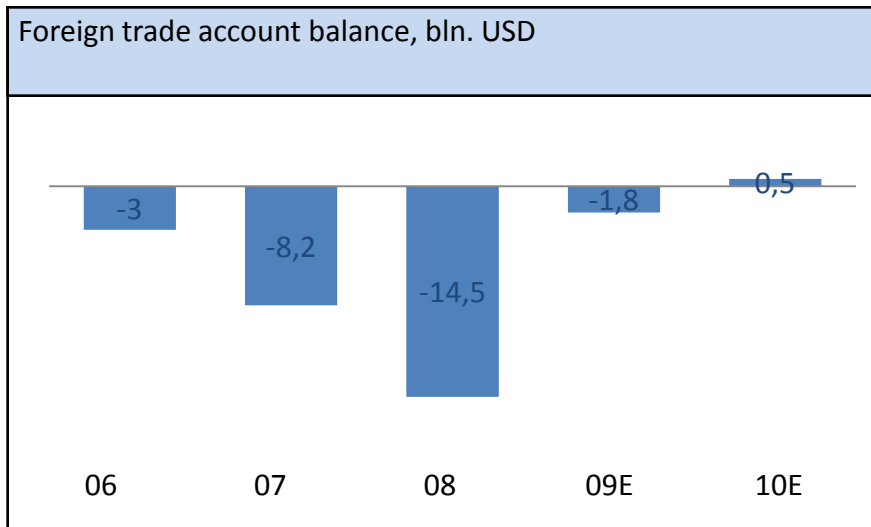
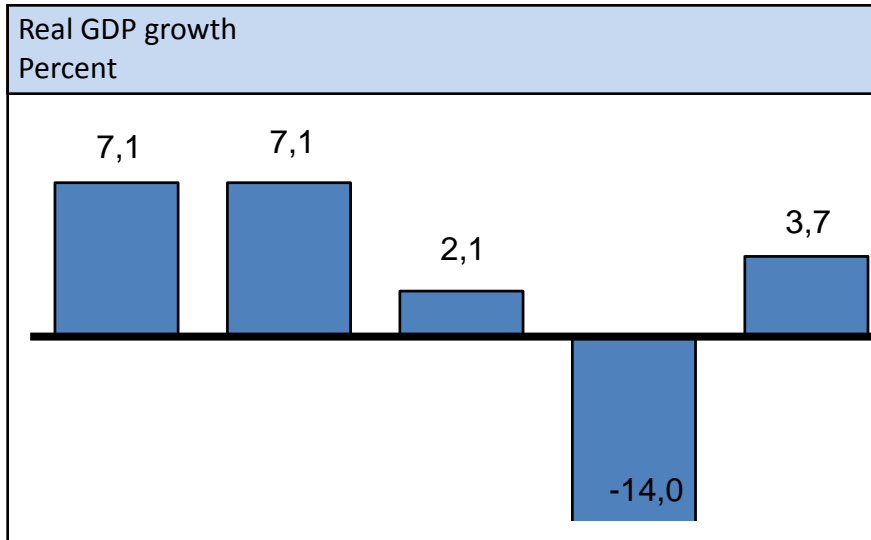
- Parliamentary-presidential republic, gained independence after the collapse of the USSR in Dec 1991
- Democratic revolution of December 2004 set high aspirations for the future
  - President: Victor Yushchenko (as of Jan 2005)
  - Prime-minister Yulia Tymoshenko
- Executive branch – Cabinet of Ministers. Legislative branch – unicameral Verkhovna Rada (450 seats)
- 25 regions (oblasts) and two cities with a special status

# Overall Economy

# Macroeconomic environment summary

	2005	2006	2007	2008	2009	2010
GDP growth, %	2.7%	7.3%	7.9%	2.1%	-14%	3.7%
Unemployment, %	7.2%	6.8%	6.4%	6.4%	9.5%	7%
UAH to US\$ at year-end	5.1%	5.1%	5.1%	7.7%	7.75	8.2
Industrial production chg, %	3.1%	6.2%	10.2%	-3.1%	-30%	15%
CPI, %	10.3%	11.6%	16.6%	22.3%	12.4%	9%

# Ukraine KPIs affected by crisis severely in 2009, yet likely to recover due to IMF assistance and economic rebound

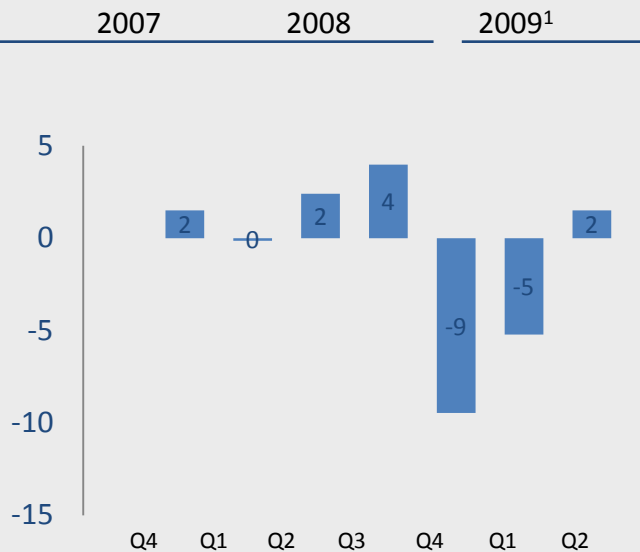


<sup>1</sup> Including Reserve Assets of the Treasury

# In spite of all this, some “Green shoots” are beginning to develop

The widening of current account gap slowed down in 1H2009 with IMF financing capital outflow.

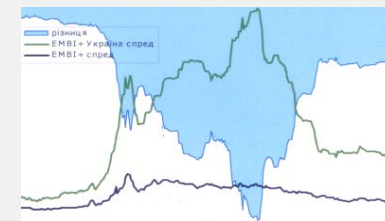
Current account balance  
USD billions



Global financial crisis

International reserves stabilized due to IMF aid

- Ukraine’s credit default spread (EMBI + Ukraine) narrowed from over 3,500bp to 1,100bp between March and August 09



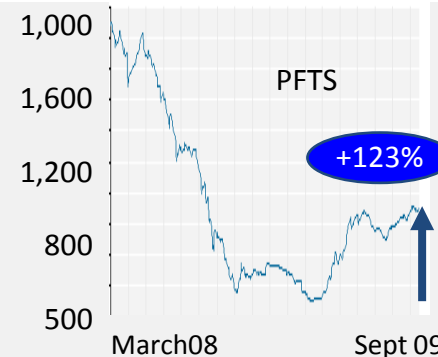
Credit default spread

Aug 08

Sept 09

Stock indices have recovered from their lows

- Though down nearly 50% from its high, Ukraine’s stock market has soared over 100% since its March 09 lows

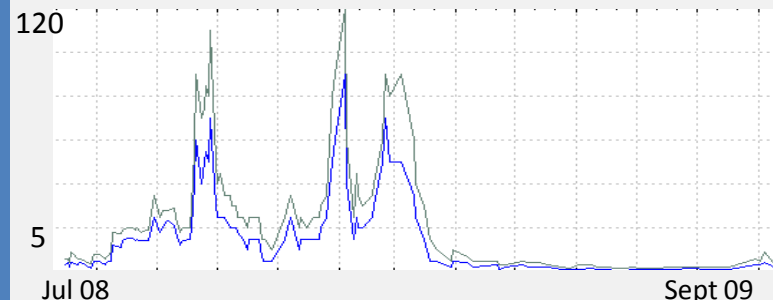


March08

Sept 09

Interbank lending rates have stabilized

Overnight KIBOR rate  
Percent



Jul 08

Sept 09

# Specifics of the Market Environment for FMCG

# Environment Specifics

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## Key Trends

## Implications for the business model

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### Market Structure

#### Channels

- Extremely fragmented trade universe
- Industry structure to undergo a far-reaching evolution
- Some channels grow extremely fast
- Internationalization progressing

- Expansive coverage models needed
- Proximity to the market and key customers is key
- Some business models have their objective “ceiling”

#### Consumer

- Large number of households –sizable market
- Significant consumption catch-up potential
- High price-sensitivity
- Urban population dominating;

- Local sourcing is a benefit
- Inventory management in the volatile environment is a challenge (stock buffers and demand planning)

#### Regulation and legal environment

- Legal environment messy, contradicting regulations
- High degree of administrative interference for some product groups
- Rudimentary state of the judiciary system

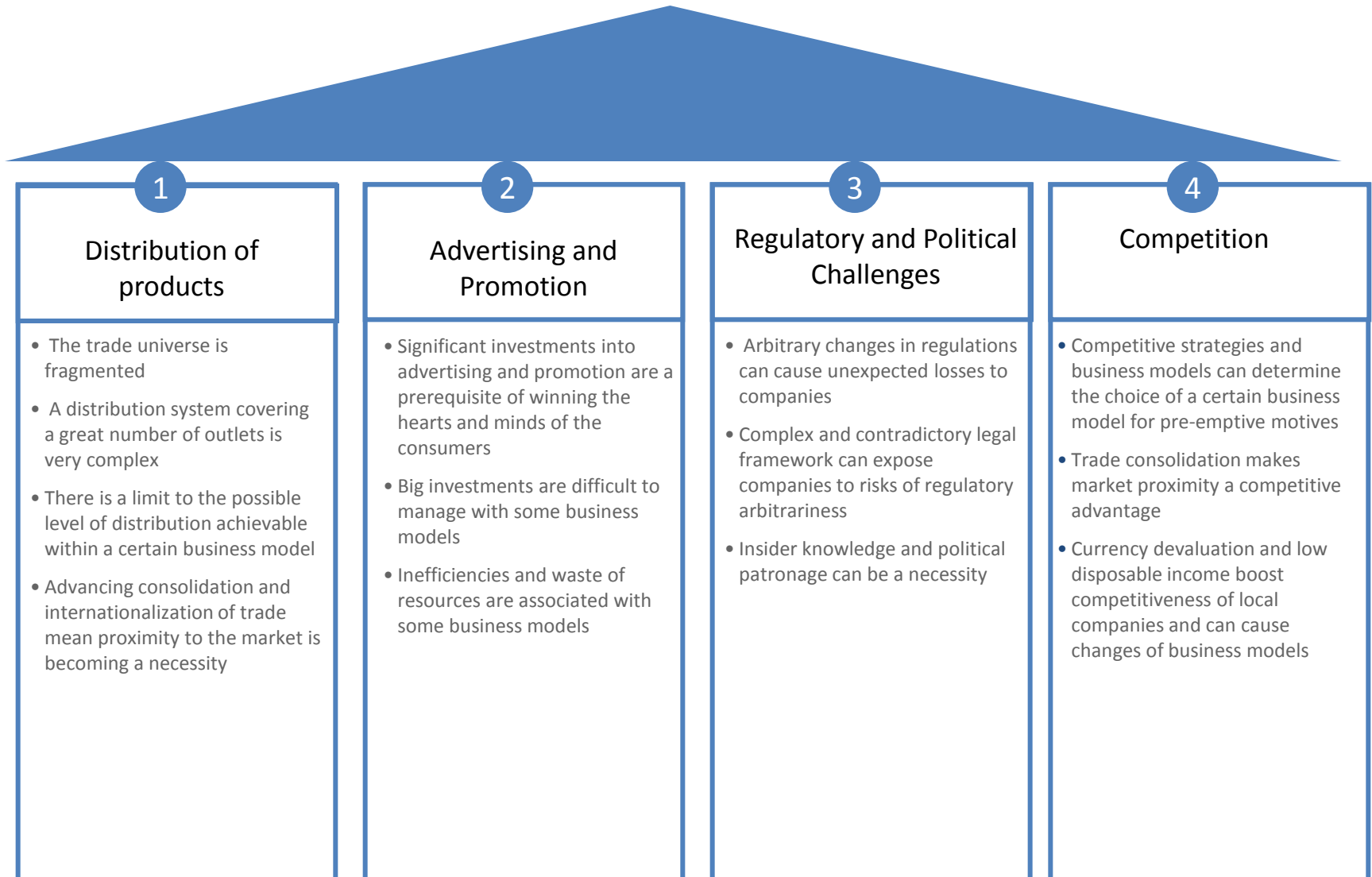
- Managing the risks sometimes means outsourcing to trade partners
- Compromises on quality of the distribution model may be a necessary evil

#### Competitive landscape

- Growing market with large size -> a battlefield for multinational and local corporations
- Local competitors strong in some industries

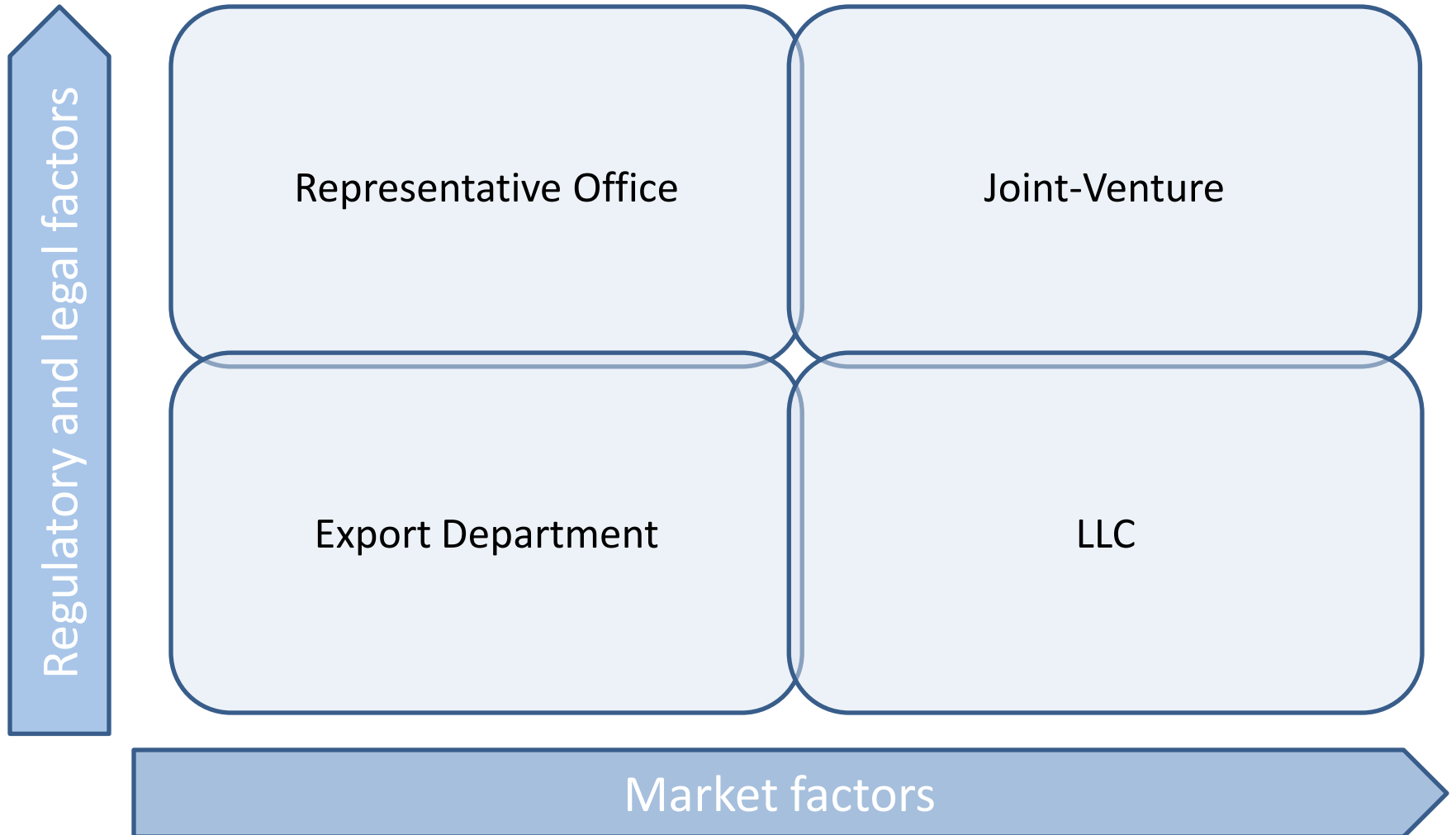
- In some markets the choice of a business model may be made by your competitors for you
- High degree of localization in value creation may dictate the choice of a certain model

# Suitable business concepts for Ukraine must be capable of managing a complex range of factors...



# FMCG Business Models suitable for Ukraine

# Most of the multinational companies operating in Ukraine operate one of four business models



# The choice of a particular business model considers a number of factors...

Political patronage and insider benefits

Market potential

Company Strategy

Investments/Cost of doing business

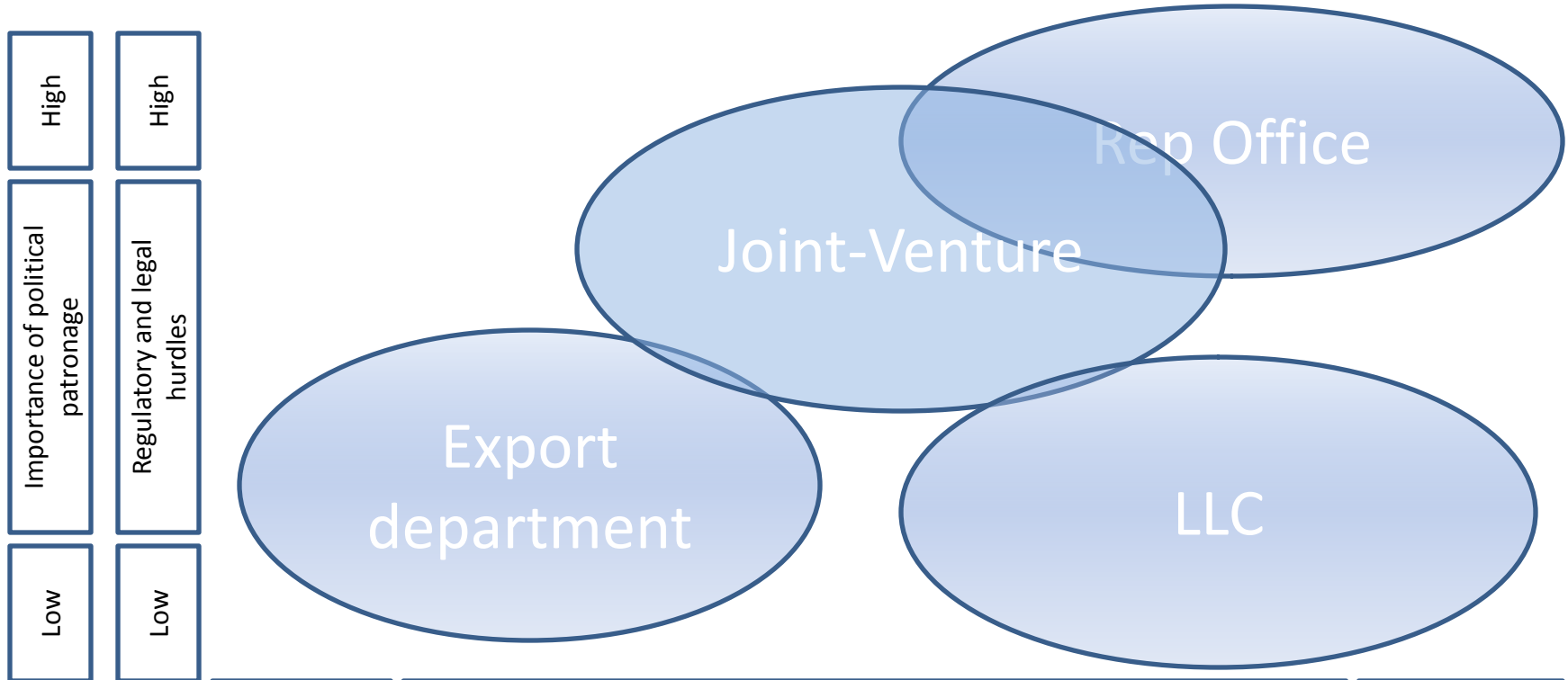
Managerial capacity

Competition

Risk profile of decision-takers

Regulatory and legal environment

# The choice of a business model typically considers several broad factor areas...



Low	Market potential	High
Short term, skimming	Company strategy	Strategic presence
Low	Investments/Cost of doing business	Long-term/High
Low	Managerial capacity	Long-term/High
Low	Competition	Long-term/High
Low	Risk profile of decision-takers	Long-term/High

# Each of the models has its benefits and disadvantages

## Benefits

## Disadvantages

### Export department

- The cheapest model

- Opportunistic, tactical model
- Not sustainable in the long-term perspective

### Rep Office

- No fixed costs
- No direct involvement with the authorities
- Small upfront investments into infrastructure
- Limited exposure to country and currency risks

- Limited control over the value chain/limited responsiveness to market changes
- “Sunk” costs in case of direct financing of promotional and advertising activity
- Running costs of the model typically higher as% of sales than in LLC model
- Permanent establishment risk

### Joint-Venture (LLC)

- Share costs/diversify risks
- Benefit from local insider-access to authorities
- Benefit from access to manufacturing facilities

- Technology migration risk
- Lack of operational control and transparency
- Possibility of litigation with local partners who are better positioned to influence the outcome of court proceedings
- A price-premium to be paid when full incorporation takes place

### LLC

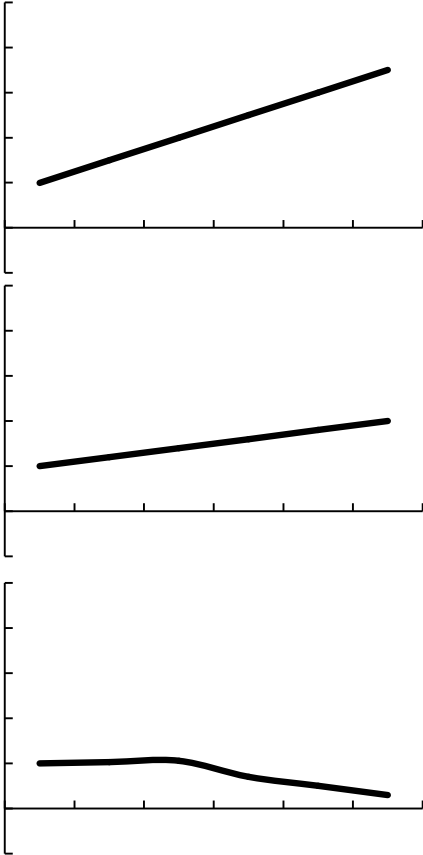
- Manageable business model/link between strategy and tactics
- Higher efficiency (running costs & go-to-market, however contingent on the critical mass)
- Greater flexibility and competitive action
- No sunk costs in case of promotional investments
- Market info and operational know-how accumulation

- Forex and country risks
- Market exit in an instant not possible
- Substantial investments into infrastructure needed
- Regulatory and legal risks

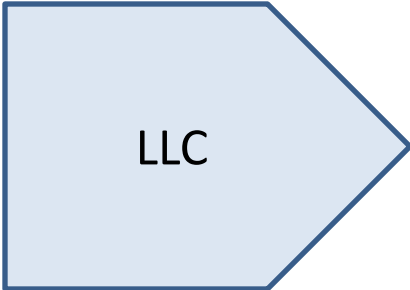
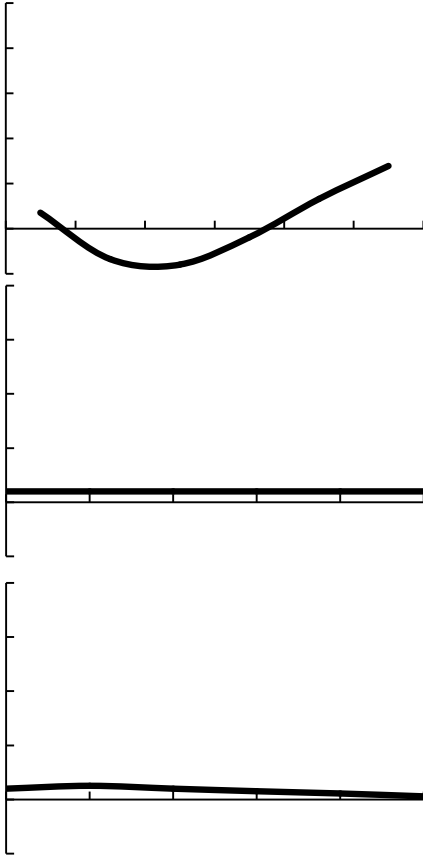
# Financial profile of different business models is different...

Financial outlook

NTS



RNI



- Steep sales curve
- Negative bottom-line in the investment phase
- Higher long-term bottom-line



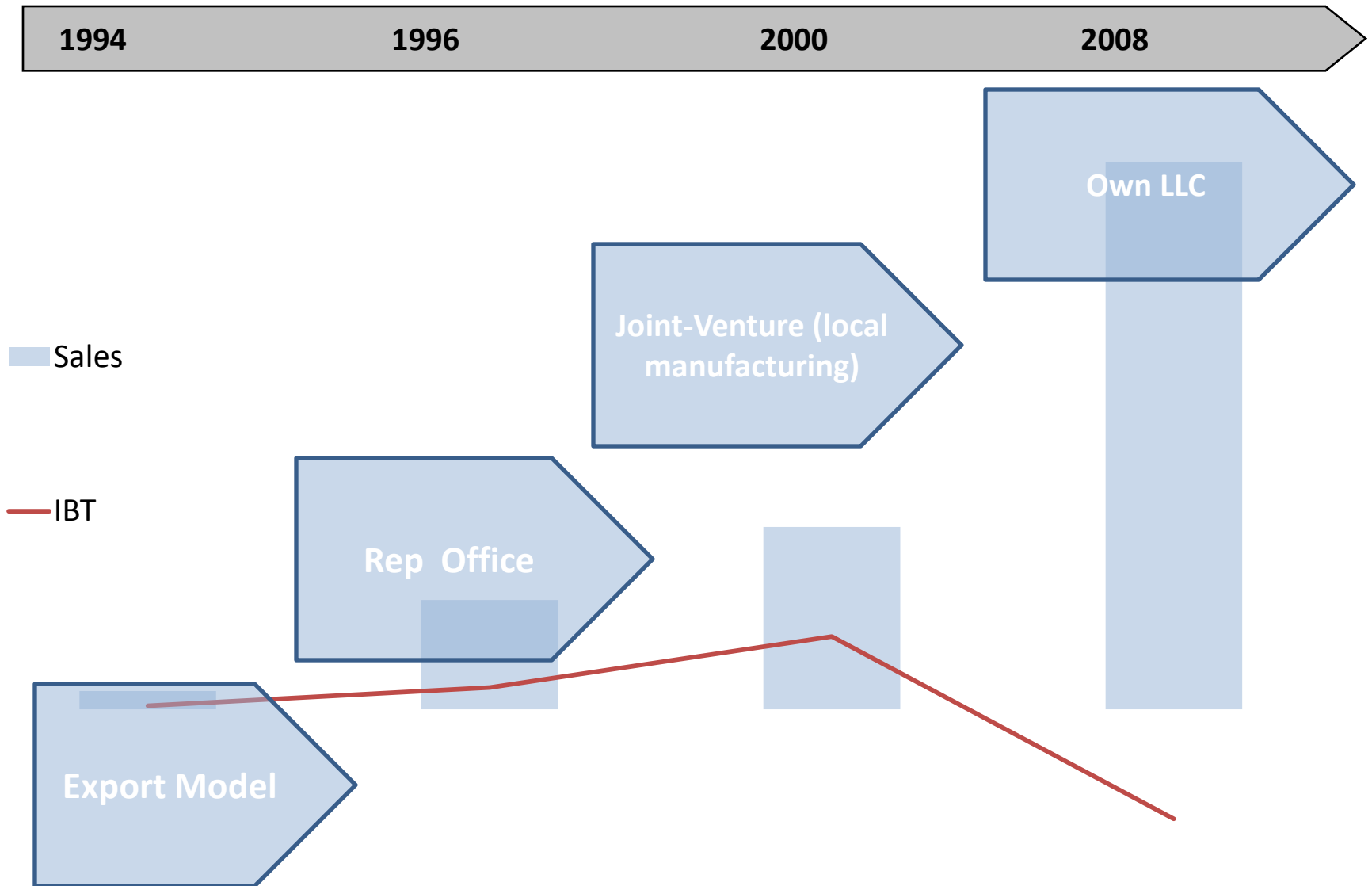
- Sales growth in line with, or slightly above market growth
- Bottom-line positive, yet low



- Sales growth in line with, or below the market growth rate
- Bottom-line positive in the short-term perspective, negative long-term

Changing from Rep Office to  
LLC: “Watch out”-areas

# Evolution of business models



# Issues arising in connection with the switch from Rep Office to LLC

## Areas of complications

## Proposed level of change and rationale

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Customs

- Transfer pricing and effective customs duties
  - A conflict between the import value and taxable profit
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Product certification and regulation

- Re-registration of some products for the new LLC necessary
  - Unexpected changes of mark-up regulation
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Distributors and wholesalers

- Old partners refusing to co-operate on new terms
  - A new round of trade term campaigning
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Currency risks

- Local currency pricing entails risks of currency losses

**Q&A**