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POLISH FDI IN UKRAINE: ANALYZING LOCATION FACTORS, MACRO-ECONOMIC TRENDS AND FIRM-LEVEL ACTIVITY

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Abstract

In the context of the literature review and the analysis of Ukraine's location advantages and disadvantages vis-à-vis FDI, the paper presents major macro- and meso-economic trends in Poland's FDI flows to and stock in Ukraine, including their sectoral distribution. It also presents the results of an analysis of 18 companies from Warsaw Stock Exchange that have invested in Ukraine. One of the main findings reveals a discrepancy between a very modest value of Polish FDI in Ukraine and a relatively large number of Polish firms' subsidiaries operating in the country. The analysis of the sample of those subsidiaries allows to conclude about their assets, FDI motives and modes, types of FDI undertaken, and sales results in Ukraine.

Keywords: Foreign Direct Investment, location factors, transition economies

JEL Codes: F24, F21, F00

Note: Updated (10/01/2014).This paper represents the first stage of a multi-stage study of Polish FDI in Ukraine and is exploratory in nature, further research is envisioned. In the next stage, we plan to conduct interviews in 8-10 companies drawn from the current sample in order to derive information on investors experience in Ukraine and their perception of its location advantages and disadvantages. The second stage should allow for formulating appropriate hypothesis to be tested through quantitative research based on a survey of all Polish companies that have invested in Ukraine, which is planned for the third stage of this project.

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Polish FDI in Ukraine: analyzing location factors, macro-economic trends and firm-level activity

by

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Introduction

With a population of over 46 million, strong, although somewhat erratic, economic growth, averaging 5% over the period of 2001-2011 (according to World Bank data), and a recent geopolitical re-orientation toward Europe, Ukraine is potentially an attractive market for FDI. And yet, for its Western Slavic neighbor, Poland, Ukraine is not among top destinations for outward FDI, tracing far behind such small countries as Luxembourg and Cyprus (Zimny, 2013). At the same time, however, Ukraine hosts the second largest number of Polish companies' foreign subsidiaries. Clearly, there's a discrepancy between the level of interest and activity of Polish companies in Ukraine, and the amount of the capital they commit to this host country. Intrigued by this discrepancy, we set out to investigate Ukraine's location advantages and disadvantages vis-à-vis FDI, the level and changes of its inward FDI, the evolution of Poland's outward FDI destined for Ukraine, and Polish investors' activity and performance in Ukraine.

Intended to be a first stage in a multi-stage research project, this paper aims at revealing major trends in Poland's overall FDI in Ukraine, its sectorial distribution, as well as patterns of behavior of a sample of companies that have invested in Ukraine. In turn, the findings of this exploratory study are expected to guide the subsequent stages of the current research project.

The paper is structured as follows. After a literature review, we consider Ukraine's FDI location factors, analyzing and assessing both advantages and disadvantages of Ukraine as a destination for FDI in general, and for Polish FDI in particular. The subsequent section is devoted to an analysis of macro- and meso-economic trends in Poland's flows to and stock in Ukraine, and an analysis of general patterns in the number and geographic distribution of Polish enterprises' subsidiaries abroad. This is followed by a presentation and discussion of the results of an analysis of a sample of 18 companies, drawn from those listed on the Warsaw Stock Exchange that have invested in Ukraine. Among other things, we look at the sample companies' Ukrainian subsidiary characteristics, modes of entry, type of investment undertaken, and sales performance. The paper is wrapped up with a concluding section, summarizing the main findings and providing insights relating to opportunities and challenges faced by Polish firms investing in Ukraine.

FDI in Ukraine: Literature Review

FDI inflows into Ukraine have attracted a limited amount of research. This is in contrast to a substantial amount of studies dedicated to inward FDI in Central and Eastern European members of the EU. The very few studies focused on FDI in Ukraine deal mostly with spillover effects of FDI, the role of FDI as a catalyst of economic development, government policy towards FDI, and the effects of political situation and corruption on FDI inflows. A number of studies focus on Ukraine's location advantages and disadvantages (these will be covered in greater detail by a subsequent section).

Lutz and Talavera's (2003) study of FDI spillover effects in Ukraine considered both negative and positive effects. Negative effects might occur in the form of increased monopoly power of multinational corporations (MNC) that might have a strong incentive to acquire and close Ukrainian competitors. As for the positive effects, these authors find FDI presence in Ukraine to be beneficial to both labor productivity and exports. This positive influence is also found, although to a small degree, among firms that did not receive FDI, which attests to the presence of FDI spillovers.

FDI in Eastern Europe is widely considered an important catalyst of economic development, especially in the case of export-oriented FDI. However, it is often emphasized that the strength of positive impact depends on the capacity of the domestic firms to absorb FDI and host country governments to facilitate its positive impacts through an appropriate institutional infrastructure. Tytell and Yudaeva's (2005) study of four transition countries, including Ukraine, indicates that knowledge spillovers occur mostly in more educated and less corrupt host country environments. These authors also point out that FDI benefits are more likely to materialize once a certain (threshold) level of FDI stock is accumulated. Eastern European governments, therefore, try to develop and introduce policies aimed at attracting FDI and stimulating spillover effects (Tytell and Yudaeva, 2005).

In turn, a study of Kudina and Jakubiak (2008), based on a survey of 120 investors in a group of the CIS countries, including Ukraine, indicates that spillovers arising from the cooperation between foreign investors and local firms are weak. This is because non-oil investors in these countries are oriented toward serving local markets and operate as "isolated players", having more links with their parent companies than with local firms, thus securing very few supplies locally. This study also reports a lack of efficiency-seeking investment and points to volatility of the political and economic environments, as well as ambiguity of the legal system and corruption as major problems faced by foreign investors in the group of CIS countries.

Research conducted by Crane and Larrabee (2007) for RAND, a U.S. military and intelligence research institution, shows that the environment for foreign trade and investment in Ukraine has been improving relatively slowly as the Ukrainian government has found it difficult to liberalize trade and improve investment climate, crucial to attracting FDI. Among several critical barriers to FDI, these authors point to corruption playing a major role, as "foreign businesses complain most vociferously about Ukrainian regulatory and legal hurdles design to elicit bribes" (Crane and Larrabee; 2007, p.11). Among other barriers are trade barriers, such as the corruption-ridden VAT reimbursement for exporters and import certifying systems. This research also provides insights into the difficulty investors encounter in Ukraine as a result of serious deficiencies in the existing law (e.g., shareholders rights of ownership are not sufficiently protected), and complex, time-consuming and costly approval procedures.

A publication of the Institute of Economic Research and Policy Consulting in Ukraine (2007) shows that despite some legislative barriers, since the beginning of 2005 Ukraine has slowly started to attract a respectable amount of FDI. This investment concentrated more on the services sector (mainly financial intermediation) than on manufacturing. The authors of this publication point out that before 2005 some of the FDI were related to privatization, mainly of several energy generating and chemical enterprises. On other hand, Mac (2008) points out that "country's success is attributable to several factors: a maturing private sector (...), the country's relatively inexpensive and well educated workforce, and Ukraine's entry into the WTO on May 16th 2008". Mac also draws attention to regulatory and legal hurdles and corruption, but calls the Ukrainian market lucrative.

The above view is also central to a report prepared by Kononov (2010) for Vale Columbia Center on Sustainable International Investment (VCC). This author points to such potential advantages of Ukraine as an FDI destination, as sizeable market, low competitiveness of domestic firms, favorable geographic location, low costs of labor and other inputs, and rich natural resources. According to Kononov, these potential advantages are not being exploited due to FDI impediments created by the legal framework, political risks and corruption.

Similarly to Kononov (2010), Tansil and Eff (2011) recognize Ukraine's FDI potential, while admitting modest current levels of FDI inflows. They state: "Ukraine has the second largest population of the former Soviet states, with abundant agricultural resources, an excellent education system and well-developed industrial base. Nevertheless, Foreign Direct Investment has been scanty" (p. 1). Although FDI has been growing and the economy is relatively stable, the politics and government scandals decrease Ukraine attractiveness and increase risks. Tansil and Eff (2011) point to a number of factors that might overcome political instability: well-educated workforce, diverse industrial structure, rich farmlands, productive mines, and a location on the periphery of Europe, providing access to European and Central Asia markets. These authors assert that the recent legislative reforms have brought changes and transparency to the economy. The reforms, together with an acceleration of privatization and enhancement of the country's financial sector, should improve Ukraine's investment climate in the future.

One of the major factors attracting investors to Ukraine might be a recent discovery of unconventional gas reserves (Lijdsman, 2010). However, Lijdsman (2010) predicts most of the foreign investors in this sector firstly targeting Poland, as it has better business climate and higher-quality institutional infrastructure. Ernst & Young's (2011) report on Ukrainian FDI also recognizes increasing interests in the natural gas sector, especially from Russia wanting to maintain its stable relationship with the country. Similarly to the previously cited studies, Ernst & Young's report shows that "Ukraine's uncertainty regarding its investments climate limits investors enthusiasm and undermines its true investment potential". Nevertheless, the report conveys an optimistic view regarding the improving investment climate of Ukraine and predicts robust growth in FDI inflows.

Recent positive changes, albeit slowly implemented by the Ukrainian government, create an opportunity to open a new chapter in the country's inward FDI. Polish companies have started investing abroad on a significant scale and they consider Ukraine to be a valuable non-saturated market (Bonikowska et al, 2012). According to Zimny's (2010) study prepared for VCC, Poland has the largest outward FDI among the new EU members, with the bulk of its outward FDI stock located in the EU. A close neighbor of Poland, Ukraine, is not a top destination for Polish investors, as far as the value of FDI is concerned. However, Ukraine as a host country features prominently when the number of foreign affiliates (FAs), employment in FAs and sales of FAs are taken into account.

Ukraine's FDI Location Factors

FDI location factors are part and parcel of FDI theories. They represent host-country determinants of FDI undertaken by firms, and one of the three pillars of Dunning's eclectic paradigm (Dunning, 2001). The importance of host-country determinants is pinpointed by Dunning (1998), who argues that: "[…] more attention needs to be given to the importance of location per se as a variable affecting the global competitiveness of firms. That is to say, the location configuration of a firm's activities may itself be an O-specific advantage, as well as affect the modality by which it augments, or exploits, its existing O advantages."

The variables typically studied under the host-country determinants include: market size and growth, political stability, investment climate, trade barriers, factor endowments and costs, agglomeration effects, cultural and physical distance, government incentives, and institutional infrastructure. Market size and growth are probably the most frequently studied host-country determinants of FDI, very often measured by the GDP proxy. They are sometimes referred to as marketing or aggregate variables (Faeth, 2009).

Busse and Hefeker (2007) found that government stability, internal and external conflict, corruption and ethnic tensions, law and order, democratic accountability of government, and quality of bureaucracy are highly significant determinants of foreign investment inflows. In the same vein, Bloningen (2005) considers the quality of institutions to be an important determinant of FDI activity, particularly for less-developed countries, and points out that such problems as poor legal protection of assets, poor quality of institutions necessary for well-functioning markets and corruption increases the cost of doing business and diminish FDI activity. Dunning (2005), and Dunning and Lundan (2008) have also recognized the importance of institutional infrastructure (II), determining FDI location decisions, particularly with respect to FDI inflows to transition economies. This view is echoed by the proponents of the "strategy tripod" model, notably Peng et al. (2008), who note: "This is because the profound differences in institutional frameworks between emerging economies and developed economies force scholars to pay more attention to these differences in addition to considering industry and resource-based factors" (p. 4).

Faeth's (2009) review of FDI theories indicates that policy variables, including host government incentives, are potentially important variables determining FDI. However, it is noted by this author that "Tax policy cannot compensate for a negative investment climate, though fiscal incentives can promote investment in a favorable investment climate" (p. 187).

Since its incorporation into the Uppsala Model (Johanson & Vahlne, 1977), the construct "cultural or psychic distance" has been given a lot of consideration in internationalization studies; however, it has been studied much less as an FDI determinant. And yet, the seminal study of the effect of national culture by Kogut and Singh (1998) provided strong evidence that cultural distance, as well as national attitudes towards uncertainty avoidance, influence choice of FDI entry mode. Examples of relatively few studies of FDI determinants incorporating cultural distance are those of Bevan and Estrin (2004), Brouthers and Brouthers (2001), Buckley *et al.* (2007), and Loree and Guisinger (1995).

While using the above theoretical considerations as guidelines, below we assess Ukraine's FDI location factors.

As transpired form the literature review in the preceding section, Ukraine certainly has location advantages vis-à-vis foreign investors. Several of these factors were mentioned in that literature review, including: a large market potential, low competitiveness of domestic companies, a maturing private sector, relatively inexpensive and well-educated workforce, rich natural resources, and a relatively well-developed industrial base. Indeed, Kraszewski *et al*. (2010) find these and other factors as stimulating direct foreign investments in the Ukrainian market. Other favorable location factors identified by Karaszewski *et al*. include: good geographic location, good prospects for economic growth, the existence of market niches, import substitution initiatives, and high returns on invested capital. Arguably, as a result of these attractions, and in spite of the many impediments to investing in Ukraine discussed below, entities from over 130 countries conducted their businesses in Ukraine in 2013. The value of the capital stock invested in Ukrainian economy in the form of FDI was 54,5 billion USD as of 01.01.2013 (State Statistics Service of Ukraine, 2013). However, this figure compares unfavorably to Poland's inward FDI stock of over 200 billion USD reported by Zimny (2013).

From Polish investors' viewpoint, Ukraine, in addition to having the above-listed attractions, has an advantage of being a geographically, politically and culturally close neighbor. Both countries are second and third largest Slavic nations, and share over 500 km-long border. The historic and ethnic ties between Poland an Ukraine are described by Burant (1993) as "the ethnic and cultural kinship of the Polish and Ukrainian peoples." Poland also plays an important role in bringing Ukraine closer to the EU and facilitating the country's EU membership in the future. Moreover, thousands of Ukrainian emigrants who have settled in Poland build additional bridges between the two peoples (according to Iglicka and Gmaj, 2010, every fifth foreigner residing in Poland is Ukrainian). Clearly, the "psychic and cultural distance" between the two country's is relatively low, although one has to keep in mind that Ukraine is a politically and culturally divided country, with its eastern part gravitating toward Russia and its western part looking forward to integration with the EU (Gorzelak & Tucholska, 2008) .

At the same time, Ukraine is plagued by political and institutional problems that negatively affect FDI inflows into the country.

Ukraine belongs to the group of transition countries, and since it gained independence in 1991, it has conducted a range of internal reforms, as well as changes within external relations. The changes have so far only slightly diminished the risks related to investing and running business activity in the country. The situation is additionally made worse by the specific economic and investment climate inherited from the socialist system, characterized by corruption and bureaucracy (Herzfeld & Weiss , 2003). It is for those reasons that foreign companies, when investing in Ukraine, must take into account the existence of a considerable political and economic risk.

Before deciding on investing in any country, foreign investors consider the potential and economic risk that exists or may appear in the host country. A number of agencies specialize in assessing loan attractiveness, economic development, competitiveness, business risk, economic freedom, and corruption in most countries of the world. The rankings for Ukraine of the most prominent of those agencies are provided in Table 1.

Table 1. Ukraine's position in international investment rankings

Institution	Index	Ukraine's position in time			
		2008	2011	2012	2013
World Economic Forum	Global Competitiveness Index (a)	72 out of 131	89 out of 139	82 out of 142	73 out of 144
Heritage Foundation	Index of Economic Freedom	133 out of 157	164 out of 179	163 out of 179	161 out of 183
Transparency international	Corruption Perception Index	134 out of 180	152 out of 182	144 out of 174	-
World Bank	Doing Business Index	144 out of 179	145 out of 183	152 out of 183	137 out of 185

Source: World Economic Forum (2007 - 2012); Heritage Foundation (2013); Transparency International (2012); World Bank (2013);

(a) Data for 2007-8, 2010-11, 2011-12, and 2012-13

One of the best known indices in that area is the one presented by the Heritage Foundation – the Index of Economic Freedom, which reflects the state of affairs concerning the most important macroeconomic parameters of 183 countries of the world. The index covers such factors as trade, taxes, governmental expenditure, investment, and property rights protection. In 2013, Ukraine occupies 161st place in the Index of Economic Freedom. This is the lowest score among countries from the European region. That ranking places Ukraine among countries where business is conducted repressively, although it must be noted that the country's position on the Index improved by 0.2 points as compared to the previous year (from 46.1 points in 2012 to 46.3 points in 2013, respectively). To compare, the first three positions of the said ranking are taken by Hong Kong, Singapore and Australia with 89.3, 88.0, and 82.6 points, respectively. Ukraine's closest neighbors quite outdistance it as regards freedom of conducting business activity, and hence offer lower risk related thereto. For example, Belarus occupies the 154th place (48.0 points), Russia – 139th (51.1 points), Poland – 57th (66.0 points), Turkey – 69th (62.9 points), and the Czech Republic – 29th place (70.9 points) (The Heritage Foundation, 2013).

Other ranking agencies corroborate Ukraine's high risk associated with running a business. Alarming is Ukraine's 137th position out of 185 states on the World Bank's "ease of doing business index" (World Bank, 2013). Such a low position in a worldwide ranking was brought about by numerous factors. For instance, to start a business in Ukraine one needs to go through an average of 10 procedures, which is almost twice as many as in OECD countries or Eastern European countries (World Bank, 2013). The whole process of starting a business lasts 69 days – which is also more than twice as long as in the above mentioned countries. The situation is similar for construction works or registering property. Procedures of gaining loans and investor protection also pose considerable problems. Many hindrances are faced by entrepreneurs due to serious deficiencies of the fiscal system – for instance high income tax rates and profit transfer tax rates. Foreign investors can take advantage of various concession when conducting business within the numerous Special Economic Zones and Priority Development Areas, which have been created firstly to attract foreign investors, and secondly to develop (economically) depressive areas by developing priority businesses. However, it must be stated that the procedure of approving investment projects conducted in those areas is complex and time-consuming. Even the process of exiting a business in Ukraine is much more costly and time-consuming than in other Eastern European countries.

As was apparent in the literature review section, one of the major factors negatively affecting Ukraine's image among foreign investors is corruption. According to the Corruption Perception Index, Ukraine is 144th in the ranking, next to Syria and Eritrea. The average level of Ukraine's Corruption Perception Index in 2004-2012 did not exceed 2.5 on a scale where 0 means a totally corrupted state, and 10 means lack of corruption (Transparency International, 2012).

In the Global Competitiveness Index ranking, prepared by the World Economic Forum for 2012-2013, Ukraine takes the 73rd position among 144 states. Although Ukraine's position improved in the most recent ranking as compared to two previous years, it is still slightly worse than it was in 2007-8. Similarly to other rankings, Ukraine's position on the Global Competitiveness Index is below that of its Eastern European neighbors, except Moldova (Belarus is not ranked).

According to the Embassy of the Republic of Poland in Kiev (2013), Ukraine's basic problems in shaping global competitiveness and favorable investment and trade conditions include:

- elaborate bureaucratic system;
- corruption;
- restrictions on buying real estate and obtaining work permits by foreigners;
- non-transparent, incoherent and changeable Ukrainian laws;
- barriers to trade;
- unfavorable regulations concerning business activity;
- high risk of business activity;
- no incentives and insufficient support for investors from local authorities;
- problems with VAT refunds (these problems concern investors active in Ukraine and exporting their products abroad);
- weak system of justice and problems with pursuing legal rights in courts (administrative bodies not respecting the law or interpreting Ukrainian law in a way that is unfavorable for Polish companies, and lack of uniform application of the binding laws, particularly by local authorities);
- Ukrainian customs services questioning and raising the value of imported goods (higher customs taxes) and frequent changes of customs laws;
- slow implementation of changes adjusting Ukrainian legislation to EU and WTO requirements;
- poor infrastructure and few border crossings, which cause long queues at the borders, particularly in the case of freight transport;
- ineffective and corruption-ridden public procurement system.

The above listed rankings and unfavorable institutional factors that have a potential to greatly discourage foreign investors from entering the Ukrainian market, make the attractive location factors discussed earlier less attractive! The next section of this paper provides an empirical verification of Ukraine as a destination for Polish FDI.

Poland's FDI in Ukraine: Analysis of macro- and meso-economic trends

The datasets used in this section are derived from several sources, of which the primary source is the World Bank online database. Additionally, the databases of UNCTAD (on FDI inflows, outflows and stock), the National Bank of Poland (NBP) and State Statistics Service of Ukraine were used. Availability of data on the Ukrainian economy is very limited – this was the primary factor determining why data from the World Bank were widely used. World Bank's data seem to be the most comprehensive and probably the most accurate public data available on FDI and related statistics. Data on the Polish economy are widely distributed; therefore, there was no problem collecting such data from sources methodologically consistent with those available for Ukraine.

FDI net inflows to Ukraine in relation to the Ukrainian GDP have been growing fairly steadily over the last 20 years (the ratio increased from 0.27% in 1992 to 4.36% in 2011). The ratio reached exceptionally high values in 2005 and 2007 (about 9 and 6%, respectively)[1]. It is worth mentioning that in 2004 (the year before the peak in the FDI/GDP ratio) Ukraine noted a significant growth in GDP (12.1%). Also, from 2005 on, the percentage of FDI inflows in relation to GDP have been fluctuating. This is most probably related to rapid Ukrainian GDP growth in the years 2002-2007 (with the exception of 2005, when the GDP growth rate was only 2.7%) and the impact of global downturn; in 2009 Ukraine reported a negative growth in GDP – about -15%. At the same time, FDI inflows to Ukraine decreased from 10.7 billion USD in 2008 to 7.2 billion USD in 2011, thus falling by 32.7% (see Appendix 1).

As can be observed by looking at Table 2, outflows of Polish FDI to Ukraine were growing steady until 2007; thereafter (perhaps also reflecting the global downturn) they decreased by 452% (382.1 million USD in 2007 vs. -84.5 million USD in 2008). In 2010 Polish FDI outflows to Ukraine increased to 108.5 million USD, but they dropped to 50.1 million USD a year later. Polish FDI stock in Ukraine was also growing – in 2001 it was 62.8 million USD and in 2011 it amounted to 932.8 million USD (1485% growth in the 2001–2011 period). However, flows to and stocks in Ukraine as a percentage of total OFDI figures for Poland were decreasing, and in the last years of the period under investigation represented only 1-2%, as opposed to over 10% and 5% for flows and stock, respectively, in the early 2000s. This trend can be construed to indicate a constant erosion of Ukraine's role as a destination for Polish FDI, at least in terms of the value of investment. To compare, Poland's FDI stock in the small neighboring countries of the Czech Republic and Lithuania stood at about 2.5 billion USD in each. However, Poland's FDI stock in Ukraine was not considerably lower than that in Russia, where Polish companies had invested over 1.1 billion USD by 2011 (Zimny, 2013).

[1] Calculations based on the data presented in Appendix 1

Table 2. Poland's FDI in Ukraine: Outflows and Outward Stock (1996-2011)

	Total FDI outflows mln USD	Total outward FDI stock. mln USD	FDI outflows to Ukraine. mln USD (% of total)	Outward FDI stock in Ukraine. mln USD (% of total)
1996	53.0	735.2	7 (13.2)	
1997	45.0	677.9	8 (17.7)	
1998	317.7	1164.7	3 (0.9)	
1999	31.0	1024.3	3.3 (10.6)	
2000	17.0	1018.3	-0.3 (-1.8)	
2001	-88.9	1157.0	9.5 (-10.7)	62.8 (5.4)
2002	228.7	1456.4	22.9 (10.0)	69.3 (4.8)
2003	305.0	2144.5	80.1 (26.3)	98.1 (4.6)
2004	900.0	3351.0	66.1 (7.3)	152.7 (4.6)
2005	3436.9	6307.6	105.8 (3.1)	194.7 (3.1)
2006	8883.2	14392.4	183 (2.1)	225.5 (1.6)
2007	5404.7	21317.0	382.1 (7.1)	394.6 (1.9)
2008	4414.3	24094.1	-84.5 (-1.9)	672.1 (2.8)
2009	4699.1	29306.7	91.6 (1.9)	690.1 (2.4)
2010	5487.0	39029.4	108.5 (2.0)	866.7 (2.2)
2011	5860.2	50044.5	50.1 (0.9)	932.8 (1.9)

Source: unctadstat.unctad.org (accessed Feb. 20, 2013), ukrstat.org (accessed Feb. 20, 2013), nbp.pl (accessed Feb. 20, 2013)

In 2008, 1106 of Polish enterprises were holding shares abroad, among them 392 were registered on the stock exchange. In 2009, the number of enterprises active abroad grew to 1313 and in 2010 it grew again to 1443 enterprises. Similarly, the number of enterprises listed on the stock exchange increased to 413 in 2009 and to 438 in 2010. In 2008, Polish parent companies held operations in 92 countries. Their subsidiaries were located in all EU countries (1465 subsidiaries in 2008, 1643 in 2009 and 1802 in 2010). In 2008 most of the Polish parent companies' subsidiaries were located in Ukraine, numbering 345. A year later, it was Germany that attracted most of the Polish firms' subsidiaries – 372. Ukraine moved to the second position, hosting 348 Polish affiliates (respectively 13.5% and 12.7% of the total number of Polish subsidiaries abroad). In 2010, the tendency had been strengthened and Germany maintained strong first position with 400 Polish subsidiaries, while Ukraine hosted 356 operations, in which Polish companies held equity stakes (GUS, 2010, 2011 and 2012). Even the second position of Ukraine according to the number of Polish subsidiaries attests to the importance of this country as a destination for Polish FDI, but it is in sharp contrast with a very modest amount of foreign investment value directed to Ukraine from Poland. It can be hypothesized based on these findings that Polish investors in Ukraine are of small size or/and larger companies are reluctant to make a major capital-investment commitment, perhaps due to the largely unfavorable FDI climate and the volatility of business environment in Ukraine.

Data from the State Statistics Service of Ukraine (2013) suggest that it is the financial sector together with manufacturing that are leading in the Polish OFDI stock in Ukraine (see Table 3). However, distribution among these two sectors was shifting over time from the manufacturing sector (56.1% in 2004 and 24.9% in 2011) to the financial sector (27.2% in

2004 and 57.2% in 2011). Trade and repair services' share was steadily declining, while that of the real estate sector – growing. The share of these two sectors taken together oscillated within the 12.3%–16.6% range. There is also a discernible growing presence of Polish agricultural FDI in Ukraine; in 2004 this industry represented only 0.9% of total OFDI stock, while in 2011 its share grew to 3.1%.

Table 3. Sectorial Distribution of Poland's Outward FDI Stock in Ukraine as % of total (2001-2011)

	Financial sector	Manufacturing	Construction	Agriculture	Trade and repair services	Transport and communication	Real estate	Hospitality	Health and social services	Public services
2001	37.1	34.6	1.9	1.1	20.7	1.1	1.6	0.0	0.0	0.0
2002	32.8	39.5	1.3	1.0	20.3	1.0	1.9	0.0	0.0	0.0
2003	35.6	41.0	0.9	1.4	15.9	1.3	3.2	0.0	0.0	0.0
2004	27.2	56.1	0.9	0.9	10.6	0.9	2.1	0.4	-	0.7
2005	22.9	57.4	0.8	0.8	11.1	1.1	4.6	0.4	0.1	0.6
2006	20.2	58.7	1.1	0.9	9.8	1.1	6.8	0.3	0.0	1.0
2007	39.2	43.2	1.2	0.8	7.3	0.7	7.0	0.2	-	0.4
2008	51.0	30.6	1.4	4.0	6.3	1.0	5.3	0.1	0.0	0.2
2009	50.4	31.0	1.1	4.7	5.6	0.9	6.1	0.1	0.0	0.2
2010	56.5	25.9	1.5	3.4	5.9	1.1	5.4	0.1	0.0	0.1
2011	57.2	24.9	1.3	3.1	4.9	1.0	7.5	0.1	0.0	0.1

Source: http://ukrstat.org/uk/druk/katalog/kat_u/publ6_u.htm (accessed Feb. 20, 2013)

Polish FDI in Ukraine: Firm-level Activity

Our analysis of firm-level activity is based on a sample of Polish companies listed on Warsaw Stock Exchange. Out of 43 companies identified on Warsaw Stock exchange as having FDI in Ukraine (which is about 10% of all companies listed), a sample of 18 companies was selected. It was a judgment sample to secure good representation of companies across economic sectors and industries, as well as allowing for a broad spectrum of company sizes and different modes of entry into the Ukrainian market.

Initially, we attempted to assess the financial outcomes of the Ukraine subsidiaries of the Polish parent companies under study. Unfortunately, data availability proved to be too limited for such an analysis to be conducted in a meaningful way and for at least a majority of the studied companies. Only a handful of them published financial data for their Ukrainian operations (and even these were presented in an inconsistent manner), and our request sent to those that did not publish such results was not successful; the contacted companies either did not reply to our e-mails (and could not be reached by phone) or rejected upfront the request. Therefore, no financial performance analysis for the Ukrainian subsidiaries is presented in this paper.

The investment and operational aspects we studied are summarized in Table 4. Table 5, on the other hand, contains sales revenue data, which are used to assess the subsidiaries' non-financial performance.

The studied companies represented a variety of sectors and industries, including financial intermediation, manufacturing, retail and wholesale trade, construction, real-estate, media, IT, and oil and gas. Most of them had only one subsidiary in Ukraine (only four had two subsidiaries). All the subsidiaries, except one, were established in the 2000s, and most of them in the latter part of the last decade (the date of the establishment for one subsidiary could not be determined). Therefore, they are fairly newly established operations and their performance may not have reached full capacity yet.

The vast majority of the studied parent companies hold 100% stake in their Ukrainian affiliates; the rest, but one, hold majority stakes. The only minority stake is held by PGNiG in Dewon; however, even in this case the Polish parent holds the largest percentage of shares among the JV partners.

The Ukrainian assets of the studied companies varied tremendously in 2011. While the two banks, PKO BP and Pekao SA, had assets close to 2 and 3 billion PLN, respectively, several subsidiaries' assets were less than 1 million PLN. Of the non-financial companies, the biggest asses (over 28 million) were held by Plast-Box, a company making plastic materials. Presumably, the Ukrainian assets of several other companies are also sizeable, but the appropriate data are missing.

Regarding the FDI entry modes, all the three modes – greenfield, acquisition, and joint venture – were used. However, there's a predominance of greenfield investments among the studied parent companies. Of the 18 companies, 11 used the greenfield mode exclusively, and four used both a greenfield and acquisition or greenfield and JV for the establishment of their two subsidiaries. The use of two different modes of entry by one investor is noteworthy. The predominance of wholly-owned subsidiaries established through the greenfield mode can be explained by high investment risk (Brouthers & Brouthers, 2001). The low cultural and psychic distance between Poland and Ukraine, as noted before, would also point to the greenfield mode, as some studies find high cultural distance to be linked to a preference for joint ventures (see e.g., Kogut and Singh, 1988). The reports of Ukrainian courts taking Ukrainian sides in ownership disputes involving foreign investors, referred to in one of the preceding sections, are yet an another argument for avoiding JVs as a mode of entry into the Ukrainian market.

The vast majority of Polish investors under study pursue horizontal type of FDI. This means that they duplicate certain value chain activities between Poland and Ukraine, typically distributing and selling products that they also market in Poland. However, in some cases the product assortment sold in Ukraine is narrower than the one offered in the domestic market, or different product lines are emphasized in Ukraine than in Poland. For example, Agora's subsidiary focuses more on Internet news production and distribution in Ukraine, while in Poland the company's main business is hard copy newspaper distribution. Likewise, PZU Ukraine focuses on property insurance, whereas in Poland it offers a full range of insurance products. The predominance of horizontal investment points to market-seeking motives of Polish investors. The almost total lack of inferred efficiency-seeking motives is surprising, given the location advantages of Ukraine discussed before (notably, relatively inexpensive and well-educated workforce), but confirmed by some other studies (e.g., Kudina & Jakubiak, 2008). One could argue that this situation is unfortunate for both Ukraine and foreign investors. For Ukraine it means weak FDI spillovers and problematic contribution of foreign investors to productivity growth, employment and industrial upgrading. For investors, it means missing out on the potential to rationalize value-chain configurations and increase their operational efficiency through investment in Ukraine.

One of the two companies that are engaged in vertical FDI in Ukraine is an energy giant, PGNiG. Its Ukrainian subsidiary, Poltava Services LLC, is involved in oil and gas exploration (geophysical and geological surveys and well drilling) and is a subsidiary of GK PNiG Kraków (a Polish subsidiary of PGNiG). While Poltava represents rather horizontal FDI (basically, it provides the same exploration services as its Kraków-based parent), Dewon CSJC was set up to extract natural gas from the Sachalin field in Eastern Ukraine for the Polish market, and therefore can be categorized as vertical FDI. Dewon is also a rare case of resource-seeking FDI motives among the studied companies. However, Dewon currently does not have a license to extract natural gas in Ukraine; the license expired in 2009 (!), and until now PGNiG has been unable to regain the license due to political maneuvering and bureaucratic hurdles it faces in Ukraine (PGNiG, 2012, p. 115).

For most of the studied companies Ukraine is not the only foreign market where they have invested. Some of them, like Inter Cars, Comarch and PGiNG, have operations in multiple foreign markets. For three companies (PKO BP, Plast-Box and Agora), however, Ukraine is the only country of foreign investment. A concentration on Central and East European markets is another feature of the geographic scope of the internationalization via FDI of the companies under study; more than half of the companies have their subsidiaries located exclusively or predominantly in this region.

Table 5 provides information on sales revenues of a subsample (for which such data were available) of the investigated Ukrainian subsidiaries, for a four-year period (2008-2011). Generally, wild year-to-year fluctuations and great differences between the subsidiaries can be observed in those sales revenues. Only a third of the subsidiaries included in the table experienced strong and consistent growth in sales, namely: Beta-Reda-Ukraina (close to 240% growth between 2008 and 2011), GT APLISENS-TER (around 200%), and Plast-Box (around 130%). Since Beta-Reda-Ukraina was established in 2007, this can be considered a stellar sales performance. The other two companies were established in mid-2000s. Of course, part of this growth was eroded by inflation. Nevertheless, all the three subsidiaries were performing very well, as far as sales are concerned. Since for Plast-Box Ukraine is the only FDI host country, it makes this company sales performance even more admirable. Other subsidiaries were experiencing sales declines in one or two years of the three-year period, for which delta was calculated, and one company (Mercor) had lower sales in 2011 than in 2008. An interesting case is provided by Agora. After it was established in 2007, it experienced a jump in sales between 2008 and 2009 (by over 700%), but in the subsequent years the sales declined sharply. In conclusion, the sales dynamics of the nine companies for which sales data were available represents a whole spectrum of performance, from stellar to disastrous.

Table 4: Summary Characteristics of a Sample of Ukrainian Subsidiaries of Polish Foreign Direct Investors

Name of parent company	Sector/ Industry	Name of Ukrainian subsidiary	Year of subsidiary establish.	% of stake held by parent	Ukrainian assets, 2011 (PLN '000)	Mode of entry	Type of FDI	FDI in other countries
FOTA JSC	Wholesale trade/ automotive	FOTA Ukraine LLC	2006	70%	No data	JV	Horizontal	Czech Republic, Hungary, Slovakia
PKO BP JSC	Banking	Kredobank JSC	2004	99,6%	1 788 400	AQ	Horizontal	No investment
Complex JSC	Metals	KomplexmetalUkraina	N/A	100%	1 197	GF	Horizontal	Germany
Inter Cars JSC	Wholesale trade/ automotive	Inter Cars Ukraina LLC	2000	70%	4 785	JV	Horizontal	Czech Republic, Slovakia, Lithuania, Romania, Croatia, Latvia, Hungary, Italy, Belgium, Cyprus, Bulgaria, Germany.
Redan JSC	Retail trade/ Clothing	Beta-Reda-Ukraina Ltd.	2007	100%	11 970	GF	Horizontal	Russia
Polimex-Mostostal JSC	Construction	Cherwonogrd ZKM-Ukraina ALC Polimex-Mostostal Ukraina SAZ PrSJC	2006 2006	99,61% 100%	N/A N/A	AQ GF	Horizontal Horizontal	Romania, Italy, Germany, Russia, Hungary
Echo Investment JSC	Real-estate	Echo Investment Ukraine LLC	2007	100%	347	GF	Horizontal	Hungary, Romania
UNIBEP JSC	Construction	UNIBEP Lwów LLC	2006	100%	24 801	GF	Horizontal	Norway, Russia
Pekao JSC	Banking	PJSC UniCredit Bank	1997	100%	2 894 904	AQ & GF	Horizontal	France
Comarch JSC	IT	Comarch LLC	2004	100%	2 306	GF	Horizontal	Austria, Germany, UAE, Albania, USA, Panama, Canada, Russia, United Kingdom, Switzerland, Luxembourg, Finland, France, Belgium, China.
Zelmer JSC	Electro-engineering	Zelmer Ukraine LLC MBT Trade LLC	2007 2011	100% 100%	N/A	GF GF	Horizontal Horizontal	Czech Republic, Slovakia, Russia, Hungary, Romania, Bulgaria
Quantum Software JSC	IT	Quantum International Ltd.	2008	100%	N/A	GF	Horizontal	Russia

Mercor JSC	Building materials	Mercor Ukraina LLC	2006	55%	1 033	JV	Horizontal	Romania, Russia, Spain, Slovakia, Czech Republic
Plast-Box JSC	Plastics materials	Plast-Box Ukraina LLC	2004	100%	28 182	GF	Horizontal	No investment
PZU JSC	Insurance	PrJSC IC PZU Ukraine Life Insurance PrJSC IC PZU Ukraine	2005 2005	100% 100%	80 607 145 986	GF GF	Horizontal	Lithuania
PGNiG JSC	Oil & gas	Poltava Services LLC Dewon CJSC	2011 2000	99% 36.4%	N/A N/A	GF JV	Horizontal Vertical	Norway, Oman, Netherlands, Germany, Sweden, Libya, plus exploration concessions in Pakistan, Denmark and Egypt, and branch offices in many other countries on several continents
Agora JSC	Media	Agora Ukraine LLC	2007	100%	412	GF	Horizontal	No investment
Aplisens JSC	Electro-engineering	GT APLISENS-TER Ukraina LLC TOV-APLISENS Ukraina LLC	2005 2006	51% 100%	318 N/A	JV GF	Vertical	Czech Republic, France, Russia, Germany, Belarus

Source: Compiled by the authors based on the Annual Reports of the concerned companies

Note: GF = greenfield investment; AQ = acquisition; JV = joint venture

Conclusions

Relatively little research has so far been conducted on FDI in Ukraine, and hardly any on Polish FDI in Ukraine. As both Poland's outward FDI and Ukraine's inward FDI are expanding, the importance of this research area should not be questioned. It is important to provide new findings that can contribute to the development of FDI theory in the context of transition or emerging economies, and it is equally important to provide investing companies and policy makers with generalized insights and conclusions relating to challenges, opportunities, and successful strategies for investing in Ukraine.

As this paper clearly demonstrates, Ukraine represents a challenging FDI environment for foreign companies. In spite of the country's location advantages that relate to its market size, market growth, competitive structure, and the availability of well-educated and inexpensive labor force and natural resources, the institutional environment of business in general and FDI climate in particular represent major location disadvantages. As a result, FDI inflows to Ukraine are far below the country's potential to attract FDI. This situation is largely reflected in Polish FDI directed to Ukraine. In spite of the geographic and cultural proximity, and special political relations between the two countries, the level of Polish investment in Ukraine is very modest; currently, Polish FDI flows to Ukraine and stock in Ukraine represent only 1-2% of the value of outward FDI from Poland. At the same time, however, the second largest number of Polish investors have established their affiliates in Ukraine. Only Germany hosts more Polish subsidiaries than Ukraine. Clearly, there is a discrepancy between the value of Polish FDI in Ukraine and the level of interest and activity among Polish investors there. This discrepancy seems to deserve further studies and explanation.

Our study of a sample of Polish direct investors in Ukraine indicates that their subsidiaries' assets are relatively small (except the financial services companies, which however represent a special case); most of them were established as wholly-owned subsidiaries through greenfield investment; are predominantly involved in horizontal FDI, implying market-seeking motives; and for the vast majority of the investing companies Ukraine is not the only country where they had invested, but is typically part of a CEE cluster of investment destinations. Through our analysis of sales dynamics of a sub-sample of subsidiaries we found sales outcomes to be very uneven across the firms, ranging from stellar to disastrous sales performance.

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