



## Vladimir Dukhnenko, Vitaliy Shapran, Oksana Dubrova, Adip Khisamov Dnipropetrovsk vs. Donbass

The competition for investment between Ukrainian regions has intensified. Currently, there are three front-runners: the City of Kiev and Donetsk region have recently been joined by Dnipropetrovsk region

**E**xpert Ukraine has prepared a renewed version of the Regions' Investment Attractiveness Rating, based on 2005 data. This rating reveals the regions' disper-

sion between a greater number of rating categories. Thus, our Potential/Risk scale encompasses 12 rating categories (see Fig. 1). Whereas the results of last year's rating demonstrate that a set of just five categories was exhaustive, in the current rat-

ing version Ukrainian regions fall into as many as seven categories.

Dnipropetrovsk oblast's sudden leap forward has been the biggest surprise. This region lowered its investment risk to a medium level, moving up from 24<sup>th</sup> to





infrastructural components of the investment potential.

### The change of outsiders

Kiev remains the leader in aggregate investment potential, outperforming other regions in almost all categories (see Table 1). As a result, the capital boasts the highest development of market economy institutions. Compared to 2004, the number of private enterprises in 2005 grew by more than 10%, reaching over 43,000 by the end of the year. The amount of Kiev-registered incorporated companies has risen by 6 percentage points, while availability of retail floor area has increased by 18.3%. Kiev still holds a penultimate position on the natural resources potential and environmental risk rankings. Here, the capital's position remained intact despite the fact that in 2005 the level of pollution by stationary sources dropped by an impressive thousand tonnes. Decreased pollution is, evidently, the result of Kiev's deindustrialisation.

Donetsk region traditionally follows Kiev's lead. However, in 2005 the growth of the region's investment potential was accompanied by an increase in its risk levels. The region's slip into the maximum risk zone — with Donbass having the highest investment risk among all Ukrainian regions — is largely attributed to the shift in its economic trends. Donetsk oblast's aggregate financial performance decreased by 0.7%, and while the export of goods and services dropped by 0.8%, their import experienced a 21.3% surge. Moreover, the region's environmental and criminal risks continue to remain high (see Table 2).

Dnipropetrovsk oblast rounds up the prestigious top-three of the most attractive Ukrainian regions. In our previous rating (published in *Expert Ukraine*, May 2006), the natural resources and the economic components of this region's investment potential enabled it to marginally overtake Kharkiv oblast. As of 2005, Dnipropetrovsk region has widened the gap substantially, by over 1% of a national investment potential. Improved economic, innovation, infrastructural and financial components of its investment potential allowed the region to move up into a higher category. The region has substantially increased its aggregate financial performance (by almost 90%) due to a 31.2% growth in goods output and services provision, including a rise in the extraction sector turnover facilitated by high ore demand. Additionally, the retail turnover has surged by 37.8%. An abrupt lowering of the region's investment risk is primarily attributed to a tangible decrease in its social and environmental risks. As such,

6<sup>th</sup> place. Moreover, the improvement of its financial performance allowed the region to join the group of regions with high investment potential.

Donbass, Dnipropetrovsk's main competitor, has seen its rating slide as it plun-

ged into the maximum investment risk category. On the other hand, Donetsk oblast's already high investment potential has become even better, influenced by an aggregate improvement of the financial, economic, innovation and

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The City of Kiev remains the leader of investment potential

Table 1

Ukrainian regions' investment potential (in descending order)

2005		2004		Region	Share in aggregate national potential, %	Ranks of investment potential categories							
Rank of potential	Risk rank	Rank of potential	Risk rank			Natural resources potential	Labour potential	Economic potential	Innovation potential	Institutional potential	Infra-structural potential	Financial potential	Consumer potential
1	26	1	26	Kiev	11.41	26	1	1	1	1	1	3	1
2	27	2	27	Donetsk oblast	7.61	1	4	2	2	2	6	1	9
3	6	3	24	Dnipropetrovsk oblast	6.34	2	3	3	4	3	5	2	5
4	23	4	7	Kharkiv oblast	5.32	6	12	8	3	4	4	6	3
5	9	5	14	Odessa oblast	3.90	14	8	6	9	5	7	5	4
6	22	6	23	Zaporizhzhia oblast	3.73	15	5	5	6	10	13	9	7
7	19	8	21	Lviv oblast	3.72	12	24	12	8	6	3	8	8
8	17	11	19	Poltava oblast	3.54	13	6	4	10	12	15	7	17
9	2	9	5	Kiev oblast	3.53	5	2	7	13	9	20	25	15
10	12	10	17	Mykolaiv oblast	3.52	3	13	9	7	11	24	19	10
11	25	12	25	Luhansk oblast	3.31	7	22	10	5	8	21	27	23
12	20	14	16	Sevastopol	3.28	27	14	22	25	27	2	10	2
13	18	7	11	Crimea AR	3.12	23	9	13	14	7	12	12	6
14	5	17	8	Chernihiv region	2.93	9	18	14	11	22	23	21	18
15	10	16	20	Zhytomyr oblast	2.89	4	16	26	18	19	14	17	25
16	1	21	1	Volyn oblast	2.88	22	27	18	26	25	9	4	13
17	21	18	6	Ivano-Frankivsk oblast	2.86	10	11	15	12	17	27	11	22
18	7	13	12	Cherkasy oblast	2.84	19	7	11	21	16	25	15	14
19	11	20	13	Vinnitsia oblast	2.80	17	10	21	20	14	8	13	27
20	13	23	22	Khmelnitskiy oblast	2.78	8	17	18	24	18	18	20	20
21	8	22	3	Sumy oblast	2.76	16	20	24	15	15	11	16	16
22	14	15	4	Rivne oblast	2.66	11	19	19	27	21	22	18	24
23	15	25	18	Kherson oblast	2.62	20	23	20	16	13	26	23	11
24	24	19	2	Kirovohrad oblast	2.57	21	15	16	17	20	17	26	21
25	16	24	9	Zakarpattia oblast	2.53	18	21	25	19	24	19	22	26
26	3	26	10	Chernivtsi oblast	2.38	25	25	23	23	26	10	14	12
27	4	27	15	Ternopil oblast	2.17	24	26	27	22	23	16	24	19

Source: Expert Ukraine

## The unchanged method

We used the same method to calculate the regions' investment attractiveness rating as the one we pioneered in *Expert Ukraine, May 2006*. To account for changes in the regions' performance, we selected a 2000–2005 time range which encompasses Derzhkomstat's latest full set of annual figures.

The rating was calculated on the basis of 120 indicators: 90 for the assessment of investment potential and 30 for the estimation of risk level. Indicators were aggregated into a single indicator set. The investment potential outlines a region's ability to attract investment and encompasses the following components: natural resources, labour, economic, innovation, institutional, infrastructural, financial and consumer. The investment risk describes the probability of the loss of investment and profit and consists of the following risk types: economic, financial, social, criminal, environmental, legislative, and political.

Each region's overall rank for investment potential and risk was calculated according to the size of the weighted total of this indicator against the Ukrainian national average. For the investment potential, natural resources and labour components tend to be most significant. Among risk components, political, legislative, economic and financial types of risk are deemed the most important (see Fig. 3).

The probability of legislative and political risks was evaluated by means of expert survey. Due to the similarity of regulatory frameworks in all regions (except for ARC), the regions were treated as having similar values of risk. Contrary to the fact that the Ukrainian Constitution guarantees local governance, local authorities in fact remain subjugated to the central authorities. The value of Crimea's administrative and political risks was elevated because this autonomous republic has the authority to pass legislative acts.

Finally, every region was attributed a rank. For investment potential, higher rank was ascribed to regions with higher potential; and for investment risk — to regions with lesser risks.

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household income swelled by 35.5%, while pollution has decreased by 26.6 tonnes annually.

Luhansk oblast is the only region with a high risk-level and average potential. Its investment potential has allowed it to move up from 12<sup>th</sup> to 11<sup>th</sup> position. The improvement of this region's aggregate investment potential was made possible by minor growth of its natural resources, economic, innovation and infrastructural components. Additionally, a 7% drop in unemployment and a 30% average monthly wage increase has lowered the combined social and economic risks level.

The middle category, comprising regions with a medium level of investment risk and investment potential, includes nine regions (Fig. 1). Compared to our previous rating, the following oblasts have improved their investment potential: Odessa, Kiev (rated separately from the capital which has a special administrative status), Mykolaiv, Poltava and Lviv. Conversely, the investment potential of the Autonomous Republic of Crimea (ARC) and Sevastopol has decreased. The fact that Ukrainian regions gravitate towards a low-potential/medium risk position is directly related to the low con-



The City of Kiev and Donetsk oblast share the highest investment potential and the highest levels of risk

Table 2

Ukrainian regions' investment risk level (in ascending order)

2005		2004		Region	Risk, %	Ranks of investment risk components				
Risk rank	Rank of potential	Risk rank	Rank of potential			Economic risk	Financial risk	Social risk	Criminal risk	Environmental risk
1	16	1	21	Volyn oblast	2.76	13	1	13	13	4
2	9	5	9	Kiev oblast	2.87	12	2	5	12	17
3	26	10	26	Chernivtsi oblast	2.96	9	7	16	4	3
4	27	15	27	Ternopil oblast	3.00	3	12	15	2	9
5	14	8	17	Chernihiv oblast	3.09	5	9	18	14	10
6	3	24	3	Dnipropetrovsk oblast	3.11	22	5	3	26	5
7	18	12	13	Cherkasy oblast	3.20	25	3	11	11	16
8	21	3	22	Sumy oblast	3.22	1	17	19	15	14
9	5	14	5	Odessa oblast	3.24	18	19	2	16	13
10	15	20	16	Zhytomyr oblast	3.29	6	18	24	10	2
11	19	13	20	Vinnytsia oblast	3.29	4	10	22	9	19
12	10	17	10	Mykolaiv oblast	3.35	14	15	10	24	11
13	20	22	23	Khmelnyskiy oblast	3.41	23	16	20	8	6
14	22	4	15	Rivne oblast	3.41	16	6	26	6	7
15	23	18	25	Kherson oblast	3.45	24	11	12	21	1
16	25	9	24	Zakarpattia oblast	3.48	19	20	23	1	8
17	8	19	11	Poltava oblast	3.59	15	8	25	23	18
18	13	11	7	Crimea AR	3.62	10	14	8	25	15
19	7	21	8	Lviv oblast	3.63	2	23	9	7	20
20	12	16	14	Sevastopol	3.68	26	13	6	22	21
21	17	6	18	Ivano-Frankivsk oblast	3.77	21	4	21	3	24
22	6	23	6	Zaporizhzhia oblast	3.99	17	22	7	5	23
23	4	7	4	Kharkiv oblast	3.99	11	24	14	17	22
24	24	2	19	Kirovohrad oblast	5.12	27	26	27	18	12
25	11	25	12	Luhansk region	5.22	8	27	17	27	25
26	1	26	1	Kiev	5.63	7	25	1	19	26
27	2	27	2	Donetsk oblast	6.63	20	21	4	20	27

Source: Expert Ukraine

centration of industrial enterprises, unimpressive financial performance and the weak development of the agricultural sector. Zaporizhzhia oblast, a newcomer to this category, managed to capture its spot due to a decrease in its financial, social and criminal risks. Compared with our previous rating, Kharkiv oblast stands out among other regions in this category: the growth of economic, financial and environmental risks has relegated it from 7<sup>th</sup> down to 23<sup>rd</sup> position. The increase in Slobozhanshchyna's (the informal name of the Kharkiv region) level of investment risk is connected with major losses in wholesale trade and mechanical engineering, as well as with the growth of debt (by 43.4% in accounts receivable and by 26.4% in accounts payable). Moreover, the region's pollution level has increased by 7.5%.

Kiev oblast demonstrates stability in investment potential. It also has seen a decrease in its risk level: social tension has been alleviated by a 39% household income growth and a 10.1% drop in unemployment. These developments have facilitated the region's relocation from 5<sup>th</sup> to 2<sup>nd</sup> place.

Conversely, Cherkasy and Rivne oblasts have been relegated to the low-poten-

tial/medium-risk category. This group also includes the Chernihiv, Volyn, Zhytomyr, Vinnytsia, Sumy, Khmelnytskyi, Kherson, Zakarpattia, Chernivtsi, Ternopil and Ivano-Frankivsk oblasts. The distinguishing characteristic of this group is the high concentration of medium-risk regions near its lower border, a feature that outlines the similarity of performance between these regions. Even with minor improvements in their performance, any one of these 13 regions has a good chance of moving up to the upper category in the rating.

Khmelnyskiy oblast, an outsider in our previous rating, has moved to the low-potential/medium-risk category. The region managed to improve in all of the investment risk components and in six out of eight investment potential components (with financial and consumer components staying intact). As a result, it moved up from 23<sup>rd</sup> to 20<sup>th</sup> place on the investment potential rank, and from 22<sup>nd</sup> to 13<sup>th</sup> place on the investment risk rank.

In 2005, Kirovohrad oblast moved into the outsider category. In this region, construction investment plummeted by 22.5% and fixed capital investment dropped by 4.5%. Whereas in 2004 the region was among the leaders in the investment risk

rank, placing second, in our latest rating it plunged to 24<sup>th</sup> spot. Such a dramatic drop has to do with an 8% increase in the level of mortality, as well as an increase in morbidity. The number of crimes has also grown in the Kirovohrad region, as has the level of pollution.

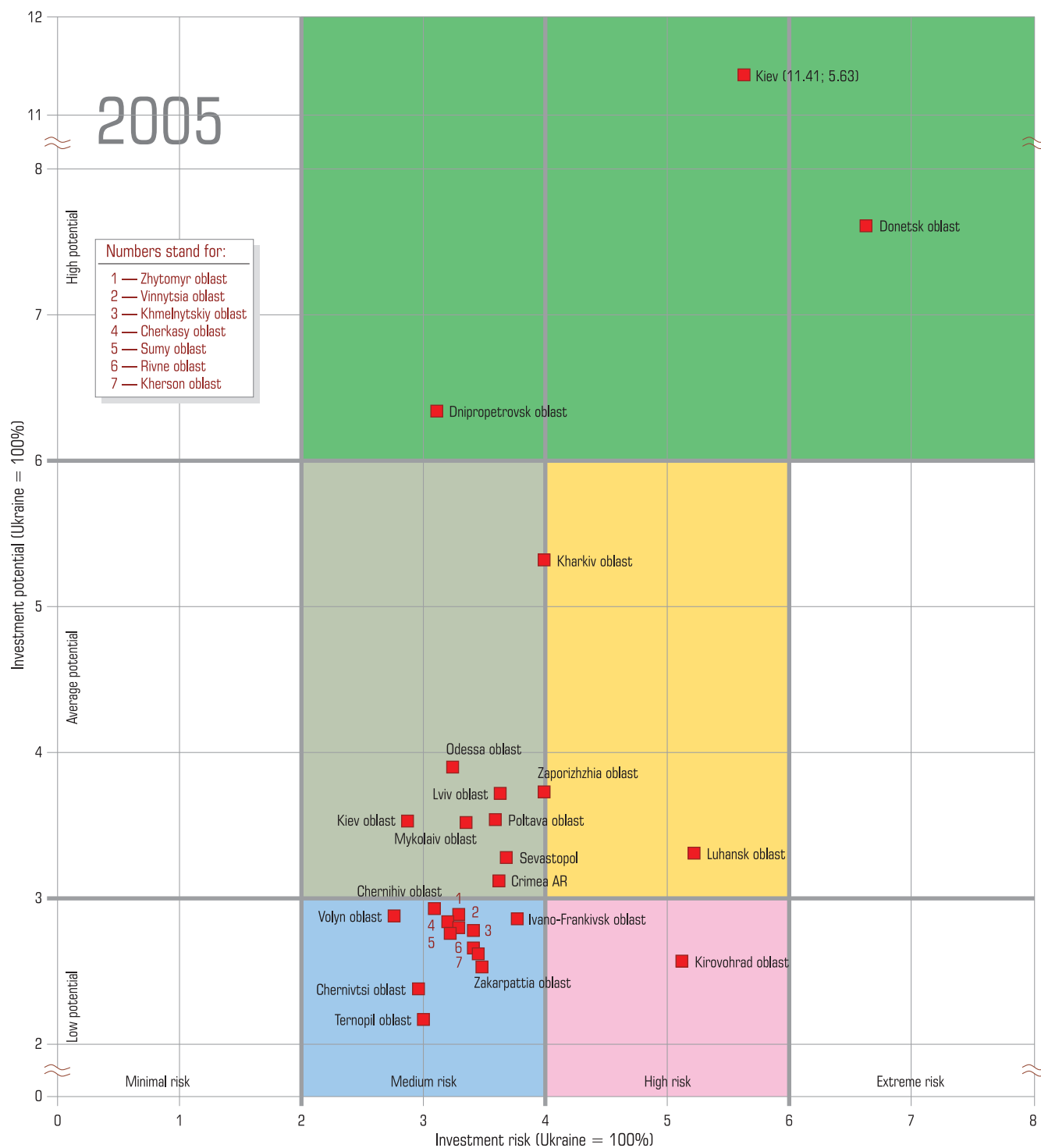
### Challengers expand their ranks

Our research revealed some qualitative changes in Ukraine's investment landscape (see Fig. 2).

The number of leading regions increased when Dnipropetrovsk region joined the City of Kiev and Donetsk oblast in the top three. Donetsk and Dnipropetrovsk are likely to become contenders for the leading position. Both are part of the Ukrainian industrial core and possess enormous resources for sustained growth, coupled with high investment potential and strong potential for financial stability. Despite the regions' elevated levels of environmental and social risks, their bright investment future is a matter of fact. Kiev will retain its role as the country's main financial and trade hub, directing increasing amounts of investment into Ukraine.

Luhansk region is the only member of the sub-leading group. As we have already stated in our previous rating, this group is

Distribution of Ukrainian regions in the rating of investment attractiveness



Source: Expert Ukraine

the least stable. As a result, two of its previous members, Zaporizhzhia and Dnipropetrovsk oblasts, changed their rating categories. However, unlike Dnipropetrovsk region, which improved its performance, Zaporizhzhia region moved into a lower category (average potential/medium risk). Such a drop in this region's performance is attributed to a 6% drop in retail turnover, a 13% export decrease and a rise in the share of loss-mak-

ing enterprises. Luhansk oblast itself — characterised by an elevated level of social, financial, environmental and criminal risks — has an opportunity to move into the outsider category. In any case, its ranking is not far from this group.

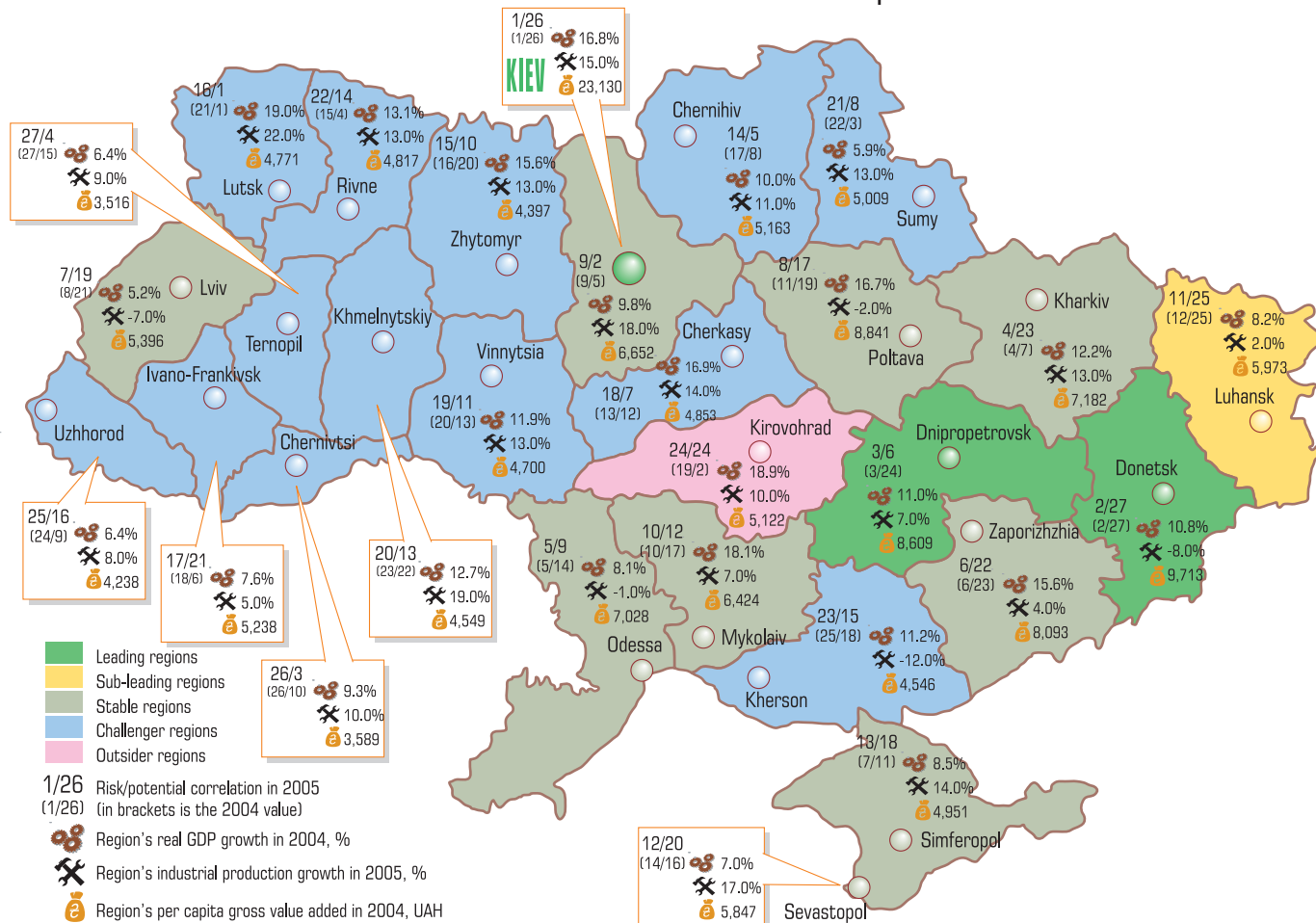
Stable regions — Kharkiv, Odessa, Lviv, Kiev, Mykolaiv, Poltava, Zaporizhzhia oblasts, ARC and the City of Sevastopol — are Ukraine's economic foundation. Regions in this group have medium levels

of investment risk and investment potential, a feature that ensures the interest of potential investors.

Challenger (developing) regions of Chernihiv, Volyn, Zhytomyr, Vinnytsia, Sumy, Khmelnytskyi, Kherson, Zakarpattia, Chernivtsi, Ternopil and Ivano-Frankivsk were joined by two former members of the stable group, the Cherkasy and Rivne regions. We strongly believe that all these oblasts have high investment potential,

## Ukraine's Investment Landscape

Figure 2



Source: Derzhkomstat; calculations by Expert Ukraine

which has so far been undervalued by potential investors. Attracting new investment depends to a large extent on the local authorities and their intention and skills to demonstrate their region's latent potential. Besides, these regions require central government support. Without it they are unlikely to attract substantial financial resources.

Kirovohrad oblast remains the only member of the outsider group. With its moderate potential, the region has an exceptionally high level of social, financial and economic risks. Despite the fact that the region is situated right in the centre of Ukraine, the absence of large cities and industrial giants, as well as investors' habitual complaints of a poor investment climate, ensured its relegation to the very bottom of our rating. The region's most acute problem is its underdeveloped infrastructure, especially its weak transport links. Kiev should consider investing primarily into the region's infrastructure. Central government authorities, together with their Kirovohrad counterparts, should strengthen their efforts in promoting the region's investment potential. After all, the City of Kirovohrad is just 300 kilometres away from Kiev.

Kirovohrad oblast, with the absence of large cities and industrial giants, relegated to the outsider group

Figure 3

The natural resources potential and political risk are the most important components of investment attractiveness of the regions

