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SELECTED BUSINESS ASPECTS OF THE EMERGING MARKET OF UKRAINE

Ukrajna feltörekvő piacának válogatott üzleti szempontjai

GÁLOVÁ, Jana¹

¹Slovak University of Agriculture in Nitra

Abstract

The current development of the world economy depends on simultaneous integration and globalization tendencies. For successful internationalization the company must know the environment of the target market and understand the consumer behaviour and needs of local consumers to choose the right entry mode. The right business strategy for companies is to compete in an integrated way that doesn't ignore country differences or give into them. The paper hereby presents an overview about the emerging market of Ukraine in terms of selected trade indicators, with some fundamental facts about political and business background. Territorial expansion requires better understanding of intercultural differences, business distance, and practice of business negotiation, therefore it should contribute to reducing the risk of entering the host market. Using the CAGE framework, developed by Pankaj Ghemawat, we propose possibilities for evaluating the environment of Ukraine. This framework provides a basis for distinguishing countries by identifying cultural, administrative, geographic and economic differences or distances between them. It is recommended to use the CAGE framework together with the AAA triangle, which stands for adaptation, aggregation and

arbitrage, and helps companies to deal with cross-border differences while serving as a strategic map for managers. The paper is completed with an overview about the ranking of Ukraine when compared with the world.

Key words: internationalization, emerging market, marketing strategy, differences

JEL Code: F18, F23, M31

Summary

A világgazdaság jelenlegi fejlődése egyszerre függ az integrációs és a globalizációs tendenciáktól. A sikeres nemzetközi működés érdekében minden vállalatnak ismernie kell a célpiac környezetét és meg kell értenie a helyi fogyasztók viselkedését és igényeit, ahhoz hogy a megfelelő piaci behatolási módot választhassa. A cikk áttekintést kínál Ukrajna feltörekvő piacáról, bizonyos kereskedelmi mutatók tekintetében, adatokkal alátámasztva a politikai és üzleti hátteret. Minden piaci terjeszkedés megköveteli az interkulturális különbségek, az üzleti távolság és az üzleti tárgyalások lebonyolításának jobb megértését, hozzájárulva a piacra lépés kockázatának csökkentéséhez. A Pankaj Ghemawat által kifejlesztett CAGE keret alapozza meg az ország környezetértékelését. Ez a keret felhasználható az országok

megkülönböztetésére a kulturális, közigazgatási, földrajzi és gazdasági különbségek, illetve távolság azonosítása alapján. A CAGE keretet együtt javasolt használni az AAA háromszöggel (adaptáció, aggregáció és arbitrázs), mely segít a vállalatoknak megbirkózni a határon átnyúló különbségekkel és egyben

stratégiai térkép a cégvezetőknek. A tanulmányban bemutatásra kerül Ukrajna rangsorolása is üzleti szempontból.

Kulcsszavak:

nemzetköziség, feltörekvő piac, marketing stratégia, különbségek

Introduction

The current development of the world economy depends on simultaneous integration and globalization tendencies. This pressure causes that businesses about to expand their territory by entering new markets are also facing the competitive environment on foreign markets. The markets of the European Union are satisfied, therefore companies must think about further possibilities in other foreign markets to be successful. Their orientation should be towards eastern rapidly emerging markets such as in Ukraine where there are appropriate conditions for international trade, thanks to geographical and cultural proximity of countries. SOUSA and LENGLER [2011] highlight the fact that most studies considering international marketing strategies have been conducted in developed countries, therefore the generalization of prior research to firms in a developing country may be inappropriate.

Internationalization is a very risky venture but rewarding adventure in the same time. For successful internationalization, not only within Europe but worldwide, it is important to ask several questions [HORSKÁ 2008]:

- Does the company know the environment (economic, social, cultural, networks) of the target market and understand the consumer behaviour of local consumers?
- How good is the company at identifying and satisfying local consumer needs?
- What kind of entry mode will the company use and how strong is the support of local business partner or staff?

Material and methods

The methodology of the paper is based on researching relevant literature from some domestic, but mainly foreign sources which focus on the topic of internationalization of emerging markets and introduce Ghemawat's tools for evaluating the business environment such as the CAGE framework and the AAA triangle. The paper shows the theoretical background and the possible practical application of these tools in business activities. The data collection methods include external sources such as scientific literature of various well-known authors (mainly the works of Pankaj Ghemawat) from the field of marketing and business, specialized online publications and statistical data. The analysis of new knowledge from the area can be a source of inspiration for new firms, interested in entering new and emerging markets. By summarizing the results of the analysis we offer practical information, but also conclude with a mention of the study's limitations and suggestions for further research.

Results

The world business has undergone significant changes in the recent years. There are many authors [BECK 2004; GOLDIN and REINERT 2007; HENNIS 2005; HINTOŠOVÁ and DEMJANOVÁ 2009; HOLLENSEN 2007; HORSKÁ and UBREŽIOVÁ 2001; ROLNÝ and LACINA 2008; SVATOŠ 2009] who deal with the topic of globalization and

internationalization, while they present both terms as the interdependence of world economics by which grows the importance and meaning of international economic relations.

The environmental and cultural diversity add more complexity and uncertainty to international business, which makes managing as an operation even more difficult [GÁLOVÁ and HORSKÁ 2013]. According to GHEMAWAT [2012], adaptation to the country of origin of participants or of a company is an obvious target, although when participants come from diverse countries, this may require access to and use of systematic data on cross-country differences and focused project assignments layered on top of a common program structure. Operating at different countries needs to consider various needs, requirements and limits. There is no doubt how different economic and cultural environment can affect consumer and purchasing behavior [TOZANLI 2005]. The opposing opinion emphasizes the existing differences that cannot be quite easily removed and hence they should be taken into consideration in any entrepreneurial activity. Understanding external environment, in accordance with this approach means not to put stress on universal approaches and a homogeneous strategy: it appears more efficient to aim the effort at the identification and adaptation of fragmented markets [CATEORA and GRAHAM 2005].

KOTLER [2007] says that in current constantly changing business environment new attractive markets are opening in Western and Eastern Europe, China, Pacific and Russia. According to HOLLENSSEN [2008], while in the past the geographical proximity was a limiting factor, now the importance of its advantage is growing thanks to the globalization process.

GRANT [2010] states that every nation represents a unique combination of distinctive characteristics. Ghemawat proposes four key components to recognize and assess the extent of similarities and differences between countries – the CAGE Distance Framework (see Table 1) which identifies Cultural, Administrative, Geographic and Economic differences or distances between countries that companies should address when crafting international strategies [GHEMAWAT and SIEGEL 2011; GRANT 2010]. It may also be used to understand patterns of trade, capital, information, and people flows [GHEMAWAT 2011]. GHEMAWAT and SIEGEL [2011] continue that each of the CAGE categories can manifest themselves depending on whether one is comparing a pair of countries or looking at one in isolation. One of the distinctions between the CAGE Framework and other country analysis frameworks is its inclusion of bilateral as well as unilateral factors.

GHEMAWAT [2007] specifies the components of CAGE distance framework on an example:

- Cultural distance: Google's biggest problem in countries with prevailing use of Cyrillic alphabet seems to have been associated with a relatively difficult language.
- Administrative distance: Google's difficulties in dealing with foreign censorship reflect the difference between administrative and policy frameworks in the host country and home country, the United States.
- Geographic distance: Although Google's products can be digitized, it had trouble adapting to Russia and the CIS from afar and has had to set up offices there.
- Economic distance: The underdevelopment of payment infrastructure in Eastern countries has been another handicap for Google relative to local rivals.

Table 1. Ghemawat's CAGE framework for assessing country differences

	Cultural Distance	Administrative and Political Distance	Geographical Distance	Economic differences
Distance between two countries increases with	<ul style="list-style-type: none"> • Different languages, ethnicities; religions, social norms • Lack of connective ethnic or social networks 	<ul style="list-style-type: none"> • Absence of shared political or monetary association • Political hostility • Weak legal and financial institutions 	<ul style="list-style-type: none"> • Lack of common border, water way access, adequate transportation or communication links • Physical remoteness 	<ul style="list-style-type: none"> • Different consumer incomes • Different costs and quality of natural, financial, and human resources • Different information or knowledge
Industries most affected by source of distance	Industries with high linguistic content (TV, publishing) and cultural content (food, wine, music)	Industries viewed by government as strategically important (for example, energy, defense, telecommunications)	Products with low-value-to-weight (content), that are fragile or perishable (glass, milk) or dependent upon communications (financial services)	Products whose demand is sensitive to consumer income levels (luxury goods). Labor intensive products (clothing).

Source: GHEMAWAT [2001] in GRANT [2010], p. 389.

Ghemawat emphasizes that different types of distance matter to different extents depending on the industry. Because geographic distance, for instance, affects the costs of transportation, it is of particular importance to companies dealing in heavy or bulky products. Cultural distance, on the other hand, affects consumers' product preferences. It should be a crucial consideration for a consumer goods or media company, but it is much less important for a cement or steel business GHEMAWAT and SIEGEL [2011].

Ghemawat displays the effect that these distances impose on the amount of trade possible to generate with companies, which are distanced from the focal firm, by showing that colonial ties between two countries can increase trade by 188 %, common currency by 114 %, and common land border by 125 % [CHRISTENSEN 2012].






GHEMAWAT and SIEGEL [2011] offer some advice on how the CAGE Framework can help managers considering international strategies. Except the fact that it makes distance visible for managers, it also helps to pinpoint the differences across countries that might handicap multinational companies relative to local competitors. It can shed light on the relative position of multinationals from different countries (e.g. it can help explain the strength of Spanish firms in many industries across Latin America) and it can be used to compare markets from the perspective of a particular company.

HORSKÁ et al. [2007] think that global companies should try to find compromise between standardization (globalization) based on common features and adaptation (localization) towards national or regional characteristics, needs and expectations of markets. The opinions of Ghemawat and Friedman on globalization differ from the previously mentioned in many ways. FRIEDMAN [2005] believes that technological innovation has removed many of the barriers that limited lots of businesses to a local playing field. But GHEMAWAT [2009] argues that the differences between countries are still significant. The right business strategy is neither the local customization nor the global standardization, or the one that compromises between those two extremes. Instead, he believes that companies must compete in an integrated way. Ghemawat's tool to help companies deal with cross-border differences is called the AAA triangle which serves as a strategic map for managers [GHEMAWAT 2007].

The share of earnings used on the promotion presents the importance of adaptation for the company. Adaptation is the strategy used by companies when they seek to boost revenues and market share by maximizing local relevance. Adaptation in countries with Cyrillic alphabet such as Ukraine means most importantly to overcome language barriers with translating the product and all its aspects to fit local conditions. The share of expenditures on research and development means the importance of aggregation. Aggregation describes the attempt to deliver economies of scale by creating regional, or sometimes global, operations. Ukraine has great prerequisites for them, whereas it is the largest country in Europe and it is one of the ten most attractive agricultural land acquisition regions according to WTO report [2013] for foreign investment in land (1.2 millions of hectares of area acquired). Finally, the share of labor highlights the impact of arbitrage, when companies exploit disparities between national or regional markets (often by locating different parts of the supply chain in different places; e.g. call centres in India, factories in China and retail shops in Western Europe). In the CIS region, migrants mainly move for work opportunities between the Russian Federation and Ukraine and between the Russian Federation and Kazakhstan. Managers should concentrate on values around the median – these are strategically the most important [GHEMAWAT and SIEGEL 2011].

The ease of doing business index is an index created by the World Bank. Higher rankings indicate better, usually simpler, regulations for businesses and stronger protections of property rights. Empirical research funded by the World Bank to justify their work show that the effect of improving these regulations on economic growth is strong [WORLD BANK 2013b]. A nation's ranking on the index is based on the average of 10 subindexes. Doing Business 2014 is benchmarked to June 2013 (see Table 2). Ukraine's position has improved by 28 places, mainly due to better dealing with construction permits and smoother register of property, but compared with V4 countries (members of the European Union) still lags behind despite biggest population and land area among them.

Table 2. Doing Business 2013 – Comparison of V4 countries and Ukraine

Country/region - Rank	2014	2013	2012	2011	2010	2009
 Slovakia	49	43	48	41	42	35
 Hungary	54	52	51	46	47	41
 Poland	45	48	62	70	72	72
 Czech Republic	75	68	64	63	74	66
 Ukraine	112	140	152	145	142	145

Source: WORLD BANK [2013b], Own editing [2013].

According to the Global Connectedness Index 2012 [GHEMAWAT and ALTMAN 2012], Ukraine ranks 52nd in the world and 27th within Europe. Ukraine's highest position is on the trade pillar, where it ranks 34th out of 140 countries, 31st on trade depth and 73rd on trade breadth. Among European countries, Ukraine has the fourth highest share of its merchandise exports going to other regions (outside Europe) and the second highest share among non-EU members (after Switzerland). Ukraine's connectedness was rising swiftly prior to onset of the financial crisis, suffered a moderate decline, and has recovered to set a new record in 2011.

The World Bank [2013a] in its Doing Business 2013 report states that Ukraine has made the following steps in order to make business environment more attractive:

- Starting a business: Ukraine made starting a business easier by eliminating the minimum capital requirement for company incorporation as well as the requirement to have incorporation documents notarized.

- Registering property: Ukraine made property transfers faster by introducing an effective time limit for processing transfer applications at the land cadastre in Kiev.
- Paying taxes: Ukraine made paying taxes easier by implementing electronic filing and payment for medium-size and large enterprises.

For better understanding formal and informal business relations of Ukraine there are provided some fundamental facts on economic and social development as well as historical and political background affecting business communication.

The situation in Ukraine is considerably influenced by its strategic position which served as a basis when creating the basic principles of its foreign policy. The foreign policy oriented at the integration into the European and Euro-Atlantic structures (NATO, the EU) causes a lot of protests among a wide group of inhabitants and politicians. This fact is mostly felt when dealing with NATO [HORSKÁ 2008]. From the business and economic point of view, Ukraine is and will be linked with Russia and countries of the Commonwealth of Independent States (CIS). Almost 40 % of Ukrainian export is directed to Russia and CIS. Nowadays the cooperation between Ukraine and the EU is of a great importance. Free trade area provides lots of advantages concerning business activities (e.g. wider export possibilities).

The European Council ratified “The Common Strategy of the EU towards Ukraine” in Helsinki on December 12, 1999. The document declares the EU support in economic reforms and democratic orientation of Ukraine. Ukraine maintains foreign trade negotiations with business partners from 213 countries. Economic and financial crisis had a great impact on the realization of these activities.

The political system is parliamentary democracy. Ukraine became the independent state in 1991. The inhabitants are mostly Ukrainians. The country is religious, the Greek Catholic and Orthodox religion predominate. The manner of introducing is similar to European one. Ukrainians address themselves only by first name and the father name without the surname, no matter the age or the social status. The common greeting is shaking hands. The part of introducing is exchange of visit cards, which should be in English and Ukrainian and both should contain the function status of the card owner. Business language is Ukrainian, Russian and English language. The foreign partners should be on time for meetings, the Ukrainian partner can be a little late [HORSKÁ 2011].

As for cultural background within business activities, thorough preparation for the negotiation is presumed, as well as the effective utilisation of time while the negotiation is in effect. In the business and entrepreneurial area are significant several partial aspects of etiquette.

At the beginning of every negotiation, a lot of time is devoted to the informal dialogue. The Ukrainian companies are hierarchical arranged and the first contacts should be arranged with the top managers because they decide about everything in the final stage. The patience is very necessary at the negotiations. There are rather a lot of employed women, but never in leading positions. The Ukrainians are friendly, hospitable and they invite their guests for business lunch (in some case also later). It is necessary to prepare the toast and the guest is obliged to give his toast. It is not very suitable to speak about the power plant Tschernobyl and also to doubt about the economic potential of the country. The Ukraine cannot be changed or identified with Russia [NOVÝ and SCHELL 2005].

Conclusions

Territorial expansion outside of the EU and Visegrad Region will require better understanding of intercultural differences, business distance, and practice of business negotiation. On the other hand, it is important to use any kind of similarities among Visegrad countries and Ukraine. Common historical background and geographical proximity could create the first supposition for better understanding, and consequently, should contribute to the further trade development. The main aim of the article was to present selected business aspects of the emerging market of Ukraine and its business environment. The current turbulent political situation, however, proposes new possibilities to rethink the mentioned facts in comparison with newly brought difficulties and challenges.

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Author

Jana GÁLOVÁ

Ing.

PhD. student

Slovak University of Agriculture in Nitra

Faculty of Economics and Management

SK-949 76 Nitra, Tr. A. Hlinku 2

xgalovaj@is.uniag.sk