



# **Exporting to the Ukrainian water treatment market**

## **Case Study: Bimaks Kimya Ltd.**

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Bachelor's Thesis

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<p>Abstract</p> <p>Apart from sharing borders of the Black Sea, Turkey and Ukraine have a long history of fruitful business relations. The paper focuses on Ukraine as a target market for exporting water treatment products from Turkey. The thesis is written with the cooperation of Bimaks Kimya, the client water treatment company.</p> <p>The study is aimed to provide all the necessary information to guide the case company in the strategic decision making. Likewise, the thesis can be valuable for companies that enter the Ukrainian market or the water treatment market in particular.</p> <p>The thesis analyses Ukrainian the current environment in the whole with a particular focus on the export environment. Moreover, the Ukrainian water treatment industry is described including its main trends and demands. Additionally, interviews with the representatives of the Ukrainian water treatment companies provide their opinions and forecasts on the industry. Withal, theoretical background overviews export as an internationalization mode.</p> <p>The outcome of the research illustrates that the Ukrainian water treatment industry has a potential for new foreign manufacturers. Nevertheless, exporting is the least risky mode to enter such an unpredictable emerging market.</p>			
<p>Keywords Ukraine, entry mode, exporting, B2B, PESTEL, water treatment industry</p>			

## CONTENTS

1	INTRODUCTION .....	4
2	RESEARCH METHODS .....	6
3	CASE COMPANY AND ITS INDUSTRY .....	8
4	UKRAINE AS A TARGET MARKET .....	9
4.1	History of Ukraine in a nutshell .....	9
4.2	Ukrainian- Turkish relationships .....	10
4.3	PESTEL analysis of the Ukrainian market .....	11
5	EXPORT AS AN INTERNATIONAL MARKET ENTRY MODE.....	21
5.1	International Market Entry modes .....	21
5.1.1	Export modes .....	22
5.1.2	Non- export entry modes .....	22
5.2	Internationalization theories focusing on export .....	24
5.2.1	Uppsala model.....	24
5.2.2	Innovation-related Internationalization models .....	26
5.3	Export as an entry mode .....	28
5.4	Role of export in economics.....	29
6	UKRAINIAN WATER TREATMENT MARKET .....	31
6.1	General information .....	31
6.2	Demands for water treatment.....	32
6.3	Interviews with Ukrainian companies.....	36
7	CONCLUSION AND DISCUSSIONS .....	38
	REFERENCES .....	39

## 1 INTRODUCTION

Nowadays, more companies are striving to increase their potential by expanding abroad. The benefits of entering new markets contribute to responding to competition as well as increasing a company's value. According to Czinkota (2011), a combination of domestic and international business presents more opportunities for expansion, growth, and income than that of a domestic business alone. International business causes the flow of ideas, services, and capital across the world.

This thesis is devoted to the export of goods by a small-sized Turkish company to Ukraine. The thesis topic has been derived from the author's professional internship at Bimaks Kimya Ltd, where the Ukrainian market was the strategic focus of the company.

Author thinks that the topic is important to research, because there is not much information available about Ukraine as a market. At the same time the country with its developing economics offers a certain potential for new manufacturers.

### **Goal and objectives**

The main interview was conducted with Roy Karasu, CEO of Bimaks. Its purpose being to convey the specific needs and interests of the company which have given rise to the thesis research question: 'Does the Ukrainian market environment appear favorable to Turkish companies for the exportation of water treatment products?'

The main goal of the thesis is to gather and review information on the Ukrainian environment from an export perspective, while also providing information that will aid decision making for the client company. Thus, the research carries the strategic value for Bimaks suggesting new market opportunities. The thesis objectives can be described as follows:

- Provide a general overview of Ukraine as a target country.
- Review the theoretical background of export mode.
- Describe Ukrainian water treatment industry with its trends and demands.
- Summarize the opinions of Ukrainian companies on the condition of today's industry.

## **Limitations**

Due to the events that are taking place in Ukraine at the moment, it can often appear that information provided today is not relevant tomorrow. That is why it is recommended to consider information as pertinent for a short-term period. However, chapter 2 ('Research methods') as well as chapter 5 ('Export as an international market entry mode') provide the theoretical background, thus remain constant. For the rest of the chapters, information can not be relied upon for two years.

As for other businesses, information can be vital for companies that are planning to enter the Ukrainian market or the Ukrainian water treatment market specifically.

## **Structure of the report**

The thesis flows from methodology chapter displaying methods that were applied in the research. The next chapter introduces the case company. Also, to get a reader acquainted with water treatment business, this chapter describes industry the company operates in. The fourth chapter uses PESTEL to analyze Ukrainian market and describe factors that may influence a business. This part is important as it gives the general overview of the target country including its political and economic state.

Theoretical part of the thesis describes export as one of internationalization modes, reviews several export theories and shows the role of export in economics. The chapter is crucial as it compares export with other entry strategies as well as explains companies' decision to choose exporting.

The research part describes Ukrainian water treatment market, overviewing the general information about it, describing demands in several industries, highlighting challenges of water systems. Additionally, the chapter provides opinions and forecasts based on interviews with the representatives of Ukrainian water treatment companies.

Summarizing primary and secondary data used in the research, 'Conclusion and Discussions' part gives an answer to the research question as well as provides author's self-assessment.

## 2 RESEARCH METHODS

Qualitative research is the preferred methodology of the thesis, as the particular method best suits the purpose of the study. The chosen methodology helps to gain a deep understanding of the topic as well as to reflect people's opinions through individual in-depth interviews (IDI) which can be described as interaction between an individual interviewer and a single participant. IDI are frequently conducted because of the experiences or attitudes of participants that will reflect the full scope of the issue under study. (Cooper & Schindler 2014, 184.)

This research topic was generated according to the interests and cooperation of Bimaks Kimya as a client organization. Referring to Bhattacharyya (2006, 72), the case study method is used when the research is focused on a specific company and examines its strategy, mission, vision, operations, routines and other company-specific details and situations. This particular method can be characterized as a case study since the main focus of the research is the internationalization strategy of Bimaks Kimya.

As it's primary data, the thesis includes several IDI where the first and most pertinent interview is with the CEO of Bimaks Kimya. Due to the lack of secondary information about the Ukrainian water treatment industry, a number of structured email interviews were conducted with Ukrainian representatives of the industry. These structured interviews use the same set of questions that are asked in specific order (Cooper & Schindler 2014,153). Respecting the request of firms to remain anonymous, respondent companies were given names as "A" and "B".

The majority of information presented in this work is secondary data. According to Onkvisit and Shaw (2004, 216), secondary research can be characterized as data that was already gathered for other aims hereby, easily accessible. Generally speaking, no research should be conducted without first consulting secondary data. Moreover, secondary data should be applied whenever possible.

Aside from the Savonia library sources that constitute most of the theoretical section, the majority of secondary data was obtained from various articles published by organizations such as The United Nations, State Ukrainian Statistics, The World Bank etc.

To get a picture of today's environment in Ukraine, a PESTEL analysis was implemented. An analysis also reviewed a number of articles written about Ukraine. According to the Professional Academy 2015, PESTEL is a tool that is used for monitor-

ing macro-environmental factors that have a significant influence on businesses. The name arises from analysing the Political, Economic, Social, Technological, Environmental and Legal factors of doing business (Cavusgil, Knight & Riesenberger, 2008).

The chapter focusing on the Ukrainian water treatment market is a substantial part of this work. A significant amount of information was derived from the market study of the Ukrainian water sector conducted by Larive International .

### 3 CASE COMPANY AND ITS INDUSTRY

Bimaks Kimya is a small size company that manufactures products for water treatment applications. Company was founded in 2009 in Istanbul, Turkey. Having a favourable geographical location the company rapidly became one of the biggest exporters in the Turkish water treatment industry. Bimaks operates in the B2B field, mainly exporting to distributors, though in some cases the company sells directly to end users. (Bimaks, 2011.)

Today Bimaks exports its products to 30 countries, contributing to 60% of total sales. The major export destination is Middle East countries. However, the company would like to explore the potential of other emerging markets, Russian speaking countries in particular. Geographical location, market opportunities and wide sector of industries attracts the case company. Due to the recent break in political relations between Russia and Turkey, Bimaks Kimya decided to try the Ukrainian water treatment market first. (Bimaks, 2011.)

Water treatment is the process of changing water qualities for use in further processes or to be returned to its natural state. The treatment can be carried by mechanical, physical, biological, and chemical methods. A great amount of water treatment procedures exist. The most basic of them are filtration, disinfection, sludge drying, coagulation/flocculation in order to collect particles of dirt in water as well as pH correction to prevent corrosion by softening water. (Hunter Water Corporation, 2012.)

Bimaks customers are mainly plants that use large volumes of water in their manufacturing process. Different compounds in water can have a damaging impact on equipment such as corrosion, bacteria, sludge. To meet a high standard performance of production, Bimaks supply its clients with chemical products for water applications that support the longevity of equipment.



## 4 UKRAINE AS A TARGET MARKET

Being the largest country in Europe and the 46th largest country in the world, Ukraine occupies almost 600 000 km<sup>2</sup>. (Consulate General of Ukrainian in New York, 2012). Ukraine is a country of rich history that actively attracts the world's attention today.

This chapter will provide general information on the country by briefly reviewing Ukrainian history. Moreover, Turkish- Ukrainian relations will be studied in order to understand the background of their political and economic relationships. A PESTEL analysis will contribute in reflecting the main spheres of the Ukrainian environment and market.

### 4.1 History of Ukraine in a nutshell

Historical evidences claim Ukraine as 'Kievan Rus' (where the Russian government was formed from) up until 16th century. The country was under the influence of Poland and Western Europe during 13th-16th centuries. By 1654 Ukraine requested help from the czar of Moscow for protection from Polish. Since that moment the country's sovereignty was removed and Ukraine became a part of the Russian Empire. (Infoplease, 2014.)

The Russian revolution returned Ukraine to its independent status in 1918. Two years later, the Red Army invaded Kiev and the country was forced to join the Soviet Union. (Infoplease, 2014.)

The country once again became independent in 1991 following the dissolution of the USSR. Leaders of Ukraine, Belorussia and Russia founded a Commonwealth of Independent States (CIS) where countries slowly recovered their economies after the Soviet era. Rising inflation, high unemployment rates and withering levels of production were the consequences of broken post-soviet economies. The financial crisis in Russia followed in 1998 and weakened the Ukrainian economy even more, as the country was 40% dependent on foreign trade with Russia. As a result, foreign investors lost interest in the country. Additionally, rampant corruption caused coup d'état's and revolutions. (Infoplease, 2014.)

The recent violent protests of 2014 attracted the world's attention and caused a lot of debates. Numerous demonstrations led to new presidential elections, new govern-

ment initiatives and active politics towards the EU. Pro-Russian regions were not satisfied with the new political direction and as a result, demonstrations in Simferopol and Crimea occurred. Later on, Russian troops intervened in Ukraine under the guise of protecting ethnic Russian minorities. After a short period of time, Russia took control of Crimea and annexed the peninsula as well as providing regional autonomy to Donetsk and Lugansk. (Infoplease, 2014.)

Actions made by Putin caused a lot of criticism from the West as a “breach of International law” (Infoplease, 2014). The U.S provided support to Ukraine while actively imposing sanctions jointly with the EU against Russia. Ukraine is now divided by the interests of two world powers: The U.S that supports the new government and Russia that backs the Pro-Russian activists. After hundreds of years the new Ukrainian government strives to move away from Russian subjugation and seeks support from the West for a new start.

#### 4.2 Ukrainian- Turkish relationships

Neighbouring across the Black Sea, foreign relationships between Ukraine and Turkey have a long history. Their diplomatic relations were formed in the 1990's when Turkey became the first country to recognize Ukraine as a sovereign state (Embassy of Ukraine, 2012).

Sharing waters of the Black Sea, both countries are BLACKSEAFOR and BSEC members. Moreover, Ukrainian president Yanukovych and Turkish Prime Minister Erdogan agreed to form a free trade zone between states in 2011. (Unian, 2011.)

Turkey began to export products such as wool, tobacco, cotton, filbert and citrus plants to Ukraine in the 1920's. Wheat, sugar, wood, coal etc were imported from Ukraine.( Atam, 2013.)

According to United Nations Comtrade data 2015, Ukraine was the 27th largest export market for Turkey (1.1% Turkey exports) and 14th largest import market (1.8% of Turkey imports) in 2014. Vice versa, for Ukraine Turkey is the 2nd largest export market (6.6% of Ukrainian total export) and 9th largest import market (2.4% from the total Ukrainian import) after Russia. Referring to Daily News 2016, the country's bilateral trade reached 4.5 billion dollars.

Turkey and Ukraine have rallied together through their common conflicts with Russia. Shaping a new phase in political and economic relations, the countries recently signed an agreement that boosts their bilateral trade and increases investments (Daily News, 2016).

#### 4.3 PESTEL analysis of the Ukrainian market

The PESTEL analysis is a marketing tool used by organizations to analyse an environment they are operating in or are intending to operate in (Pestel analysis, 2016).

The PESTEL analysis will provide information on the current Ukrainian environment by examining the political, economic, social, technological, environmental and legal spheres. Nevertheless Ukraine is facing governmental changes and its economy is not yet stable. This analysis will strive to provide a clearer view of Ukraine's current situation.

#### **Politics**

Ukraine is a democratic republic under a semi-presidential system with separate legislative, executive and judicial branches. Elected President governs the country for 5 years as well as The Parliament, Verkhovna Rada. The new President Petr Poroshenko was elected on 24th May 2014. (Australian government, 2015.)

The Ukrainian political environment is experiencing rapid changes. Recent revolution amended the governmental structure, thereby giving a new hope for a better future. President Poroshenko, confectionery oligarch in the past, promised to solve the economic crisis, suppress corruption and bring peace back to the country (The Guardian, 2014). The country's internal political situation is slowly recovering and becoming more stable than it used to be.

Ukraine inherited its powerful bureaucracy from the Soviet Union where individual interests were suppressed. A number of post-Soviet countries still take top places in the rank of countries where the most man-hours per capita are spent on bureaucratic procedures. (TryUkraine, 2010.) A high level of bureaucracy is one of the main factors that hamper the emersion of new businesses. The table below compares the ease of doing business in Ukraine, Russia, Turkey and the U.S. The countries are ranked from 1 to 189.

TABLE 1. Ease of doing business ranking (Modified from World Bank Group, 2015.)

	<b>Ukraine</b>	<b>Russia</b>	<b>Turkey</b>	<b>USA</b>
Ease of doing Business Rank	83	51	55	7
Starting a Business	30	41	94	49
Registering property	61	8	52	34
Getting credit	19	42	79	2
Protecting Minority Investors	88	66	20	35
Paying taxes	107	47	61	53
Trading across Borders	109	170	62	34
Enforcing contracts	98	5	36	21
Resolving Insolvency	141	51	124	5

Apart from bureaucracy, Ukraine acquired a high level of corruption from the Soviet Union that continues to grow. According to Transparency International (2008), the highest levels of corruption were revealed in vehicle inspection (57.5%), police force (54.2%), health care (54%), courts (49%) and higher education (43.6%). By 2015 Ukraine retained its strong ranking as one of the world's most corrupt countries. Transparency International Corruption Perceptions Index (2015), ranked Ukraine at 130th place out of 167 countries where it is neighbouring with Paraguay and the Comoros. The Minister of Economy and Trade was forced in to a recent resignation as a result of the deep seated corruption that has immersed the country into a new crisis. (The Guardian, 2016). Figure below shows the rank of corruption in 168 countries where a higher number refers to the higher corruption level.

### Corruption Rank (168)

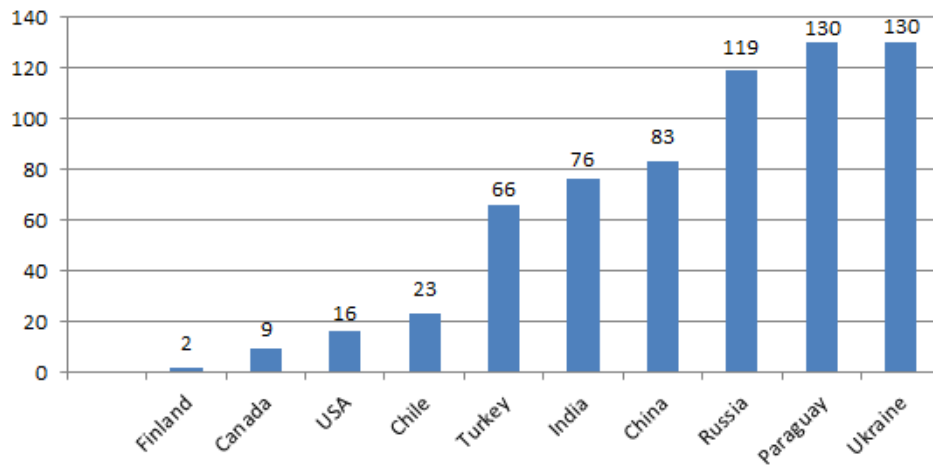


FIGURE 1. Corruption Perceptions Index 2015 (Modified from Transparency International, 2015.)

Freedom of press is another factor that should be highlighted. Freedom of press implies an independence of media and safety for journalists. A stemmed flow of information brings with it a lack of transparency that leads to fraud and corruption. According to World Press Freedom Index 2015, Ukraine takes 129th place out of 180, alongside Colombia and Morocco by rank.

During this difficult political period Ukraine hasn't suffered from trade restrictions imposed by other states apart from Russia. Conversely, weaker relations with Russia have contributed to a better relations with the EU. On the 1st of January 2016 Ukraine and the EU signed 'The Deep and Comprehensive Free Trade Agreement' that considerably facilitated trade between countries. (European Commission, 2016.)

### Economics

Ukraine is a developing free market. As a post- Soviet state, the economy of the country is strongly dependent on Russia. The World Bank ranked the Ukrainian GDP as 49th in the world.

Within the World financial crises, Ukraine faced recession in 2008-2009. The country's GDP decreased by 14.8% and but in subsequent years the country's economy was on the road to recovery. The annexation of Crimea in 2014, war in Donbass and ruined relations with its largest trade partner Russia significantly damaged Ukraine's

economy. As a result, GDP fell by 6.8 % in 2014 and a further 10.4% in 2015. (Ukraine today, 2015.) Anders Östlund, an American-Swedish economist affirms that Ukraine lost 4% of its GDP due to the annexation of Crimea, 7% was attributed to the war in Donbass(which served a crucial mining territory) and 3% of GDP was lost due to an outflow of investments (Segodnya UA, 2015). In spite of the difficulties that Ukraine is struggling with, the World Bank predicts GDP growth of 1% in 2016 (Ukraine today, 2016).

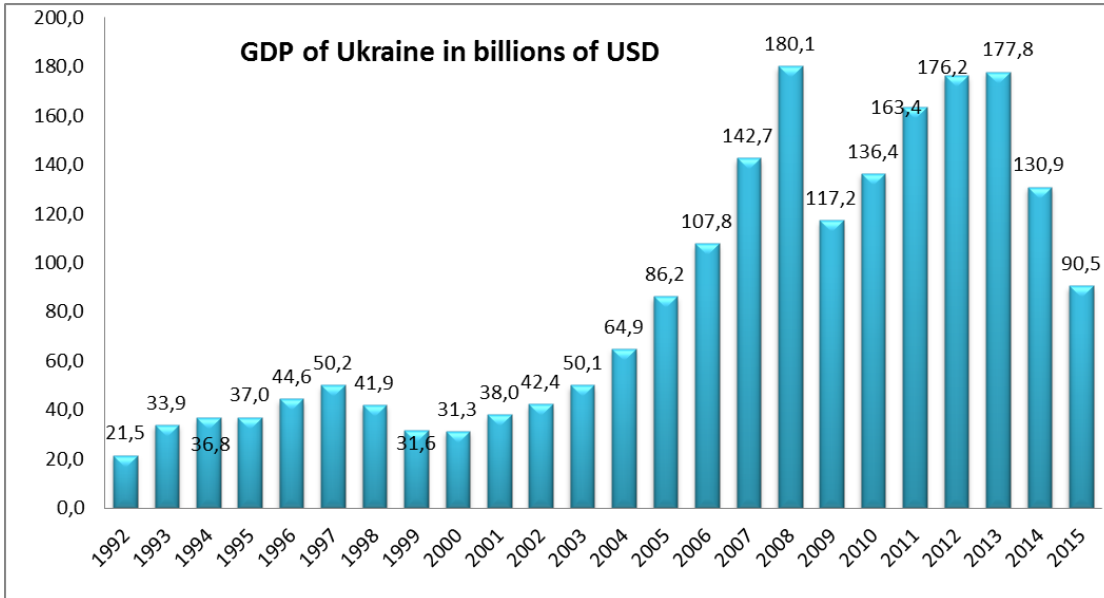


FIGURE 2. GDP of Ukraine 1992-2015(Modified from State Statistics Service of Ukraine 2015.)

As can be seen from the figure 2, the GDP of Ukraine in 2015 was notably less than 2008-2010 when the country was experiencing a recession due to the world financial crisis.

As a major component of GDP, export has also declined dramatically. The leading factor for this is the decline in production in Donbass, the main industrial region, due to the war. Interrupted production in Donbass composed 40.6% of the total export decline rate. (UNIAN, 2016.) Taking into account the period from 2005 to 2015, the figure below shows the decline of import and export, especially in the recent period of 2014-2015.

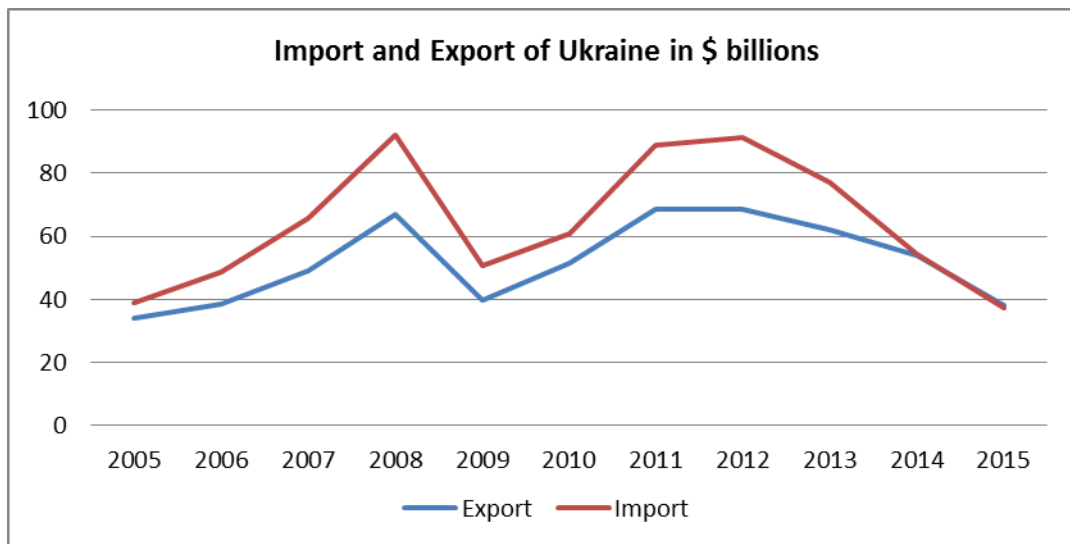


FIGURE 3. Import and Export of Ukraine 2005-2015 (Modified from Business Views & State Statistics Service of Ukraine, 2015.)

In spite of interrupted trade with the Russian Federation, Ukraine continues trading with its key partners such as Turkey, China, Egypt, EU, Belorussia and Kazakhstan. The main products traded are raw materials, mechanical engineering goods, chemicals, agricultural goods, food and textiles (State Statistics Service of Ukraine, 2015).

Due to a reduction in trade, the national currency (hryvna) started falling in value. In 2014 the National Bank of Ukraine changed hryvnia into floating currency, as a result, hryvnia lost 70% of its value against the U.S dollar. By February 2015 hryvna reached its historical minimum. (Finance UA, 2016.) Devaluation of the national currency then caused inflation growth. The inflation level of 2015 reached its maximum (43.3%) for the last 20 years. (Finance UA, 2016.) In order to curb the inflation rate and stabilize the hryvna, Ukraine's central bank took action to increase interest rates from 19.5% to 30% (BBC, 2015). However, by 2016 Ukraine reinstated its interest rate at 19% (Trade economics, 2016).

Last year one of the key problems facing Ukraine remained a high unemployment rate. Older generations are struggling with massive labour reduction while the young population have minimal opportunities to find work placement. By 2015 unemployment had reached the highest level for entire history of independent Ukraine. According to the Ministry of Social Policy of Ukraine, 5 million citizens are currently without work. (Ukraine today, 2015.)

In order to create more workplaces as well as to bring more capital to the country, the Ukrainian government strives to attract foreign investors by enacting favourable for-

foreign investment laws, motivating investors to purchase property. However, corruption and tough bureaucracy altogether with weak economy are the lead factors that discourage potential investors. (Mondaq, 2013.)

## **Society**

The population of Ukraine is 42,721,954 excluding Crimea and Sevastopol (State Statistics Service of Ukraine, 2016). The official language of the country is Ukrainian, however the second most spoken language is Russian due to large ethnic groups. According to a population census of 2001, the Ukrainian language is used by 67, 5% of population and 29,6% of population speak only Russian. (State Statistics Service of Ukraine 2001.)

Currently, Ukraine is in a situation where its two main ethnic groups are in confrontation with one another inside the country. West and East Ukraine have always been different from each other. Primarily, unlike the Eastern part the West never belonged to the Russian empire. (Yekelchuk, S, 2007.) There are noticeable cultural differences between the regions (BBC, 2014). Sharing common religion and similar values but speaking different languages and having opposing views on country's politics, this crisis of division was occurring long before pro-Russian and pro-European conflict came to the boil in 2014.

According to The World Bank Group (2008), Ukraine is facing a demographic crisis due to high rates of death and a low birth rate. Reasons that contribute to such a comparatively high death rate are high mortality rates among working age males caused by alcohol poisoning and smoking. The United Nations predicts a fall in the Ukrainian population of 10 million by 2050, should the mortality situation not improve (The United Nations, 2015, 9). In order to increase birth levels Ukraine has increased child support payments (Unian, 2007).

The figure below represents the population growth of Ukraine in comparison with Bulgaria, Latvia, Poland and Russia.



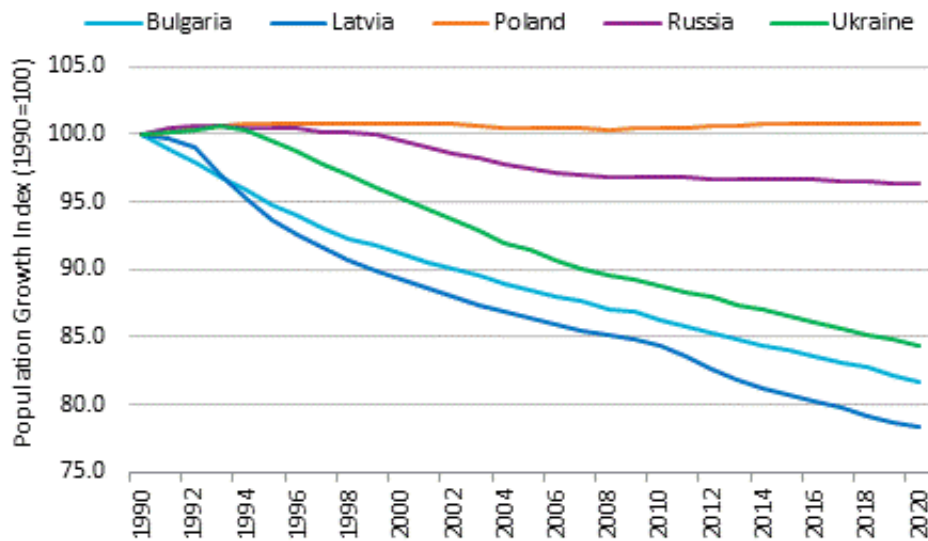


FIGURE 4. Population growth 1990-2020 (Euromonitor International, 2012.)

Age distribution plays a key role in a government's socio-economic issues. If a young population (under age 15) holds a majority against the old, then a country should invest more in schools. Conversely speaking, countries with a majority of old population (age 65 and over) should focus their resources on health care. (Index Mundi, 2015). According to the Index Mundi 2014, the population bracket of 25-54 is most prevalent in Ukraine at 45%. The percentage of older generation (65 and over) is greater than the youngest generation (0-15). (Index Mundi, 2015.)

According to a social poll conducted by Gallup, Inc. of 2015, Ukrainians rank their standard of living on 4 out of 10. That rating is the lowest for the entire period of observation. In 2015, 36% of respondents confessed that they are suffering which is the highest percentage among post-Soviet countries. The majority of respondents (79%) estimate the country's economic situation is very poor and 17% satisfied with their lives. Overall, the expectations of most Ukrainians can only be classified as depressing. However, the recent revolution has instilled a power to society that it can influence a country's destiny. (DeLong.R , 2016.)

There are great changes in the mentality of Ukrainians that can be tracked. Firstly, Ukraine increased their tendency towards individualism after three generations of Soviet collectivism. During that times, people's appearance highlighted their socioeconomic status rather than personality. Nowadays, citizens do not draw attention to their wealth by buying unique or fancy things as was popular in USSR. Consequently, this social trend has altered consumer culture. People focus more on the quality and value of a product rather than buying cheapest goods available, something peculiar to the times of the Soviet Union. (DeLong. R, 2016.)

## **Technology**

In spite of the political and economic issues that country is going through, there is still potential for a booming information technology sector. (Forbes, 2014). According to the AVenture company, the Ukrainian technology market is worth \$5 billion and is subdivided into four sections.

The first one is outsourcing. Outsourcing is an agreement in which one firm provides services for another (TechTarget, 2016). The outsourcing sector is the most developed in Ukraine. It employs over 50,000 engineers in 500 firms.

The second smaller but promising sector is R&D. Lots of R&D centers were launched by tech giants such as Samsung, NetCracker, Siemens and etc. (Forbes, 2014.)

E-commerce is the third sector, it refers to online shopping. E-commerce is estimated for \$2 billion that almost equal to outsourcing share in Ukrainian tech industry. (Forbes, 2014.)

The last and the most progressive sector is concerned with homegrown software companies that create and develop their own products for the global market. A number of start-ups continues to grow, however the biggest issue for new ideas is to find local financial and professional support. Lack of financial support can push start-ups to develop fast in order to be profitable and survive tough competition. (Forbes, 2014.)

## **Environment**

Describing the environmental situation in Ukraine, it is important to mention the infamous Chernobyl accident, a nuclear tragedy that happened in 1986 and contaminated one-tenth of the country's territory with radiation. Though the incident occurred 20 years ago, the Ukrainian environment is still facing the consequences of it. (Nation Encyclopedia, 2016.)

Besides Chernobyl, Ukraine has serious issues with water and air pollution. The sea receives heavy metal, organic compounds, and oil-related pollutants while the level of carbon dioxide emissions in the air is seven highest in the world. According to an analysis made in 2001, only 1,6% of Ukrainian land was protected. (Nation Encyclopedia, 2016.)

In order to protect the environment, cooperation with EU was established. It provides a budgetary support programme to implement Ukrainian Law on Fundamentals (Strategy) of the State Environmental Policy of Ukraine up to 2020. (Ukraine- EU, 2012.)

## **Legislation**

Ukrainian law is divided into three branches: Public law, Private law and International law that are further divided into more specific laws such as Civil, Criminal, Penal, Constitutional, Administrative and International law. The fundamental law of the country is the Constitution of Ukraine which was adopted in June 1996. (Verhovna Rada, 2013.)

To conclude, it is difficult to evaluate the potential of Ukraine unequivocally, due to a number of contradictory factors. Ukraine has a new political leader and at the same time, the country is still struggling with high levels of corruption and bureaucracy. Economics is experiencing rapid recession, especially after Ukraine lost its main trade partner due to the war. However, slight recovery of economic state is predicted in 2016. Ukrainian war has brought big changes into the society. Though, life quality standards remain low. Technology sector has a great potential. Lots of software companies were launched, yet lack of financial support doesn't let them to grow big-

ger. Ukraine has serious issues with water and air pollution. European Union provides financial support to protect the environment.

## 5 EXPORT AS AN INTERNATIONAL MARKET ENTRY MODE

Taking advantage of globalization, a great number of companies have decided to enter foreign markets. Unification and low trade barriers have caused an influx of international involvement from firms. The last decades have established internationalization as a key factor for companies to succeed. Hollensen (2011, 50) claims that entering new markets is the process of broadening the scope of business operations such as R&D, production, selling etc. to international markets .

This chapter will overview exporting as part of International Market Entry modes. Exporting will be compared with other modes of market entry and incentive theories to choose the exportation discussed. Additionally, the chapter will describe the advantages and disadvantages of each type of export mode. Furthermore, export will be overviewed from an economic perspective.

### 5.1 International Market Entry modes

*An international market entry mode is an institutional arrangement necessary for the entry of a company's products, technology and human capital into a foreign country or market (Hollensen 2011, 315).*

A great number of entry modes exist. Albaum & Duerr 2008, divided entry modes into two categories: export and non-export. Both of which are subdivided specifically. The figure below shows this division:

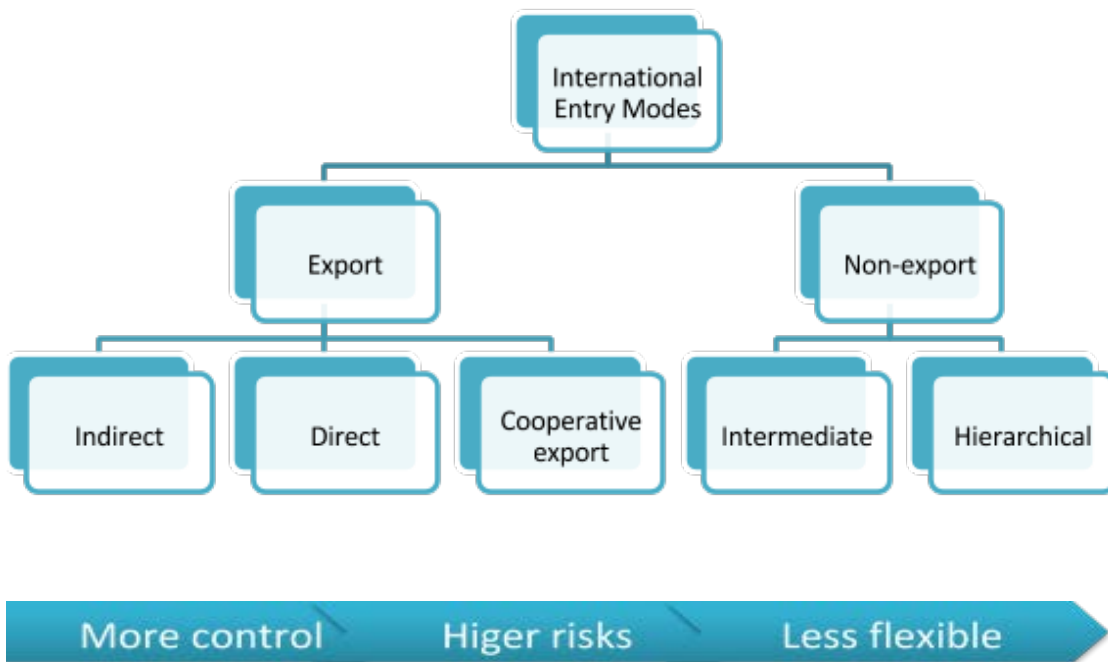


FIGURE 6. International entry modes (Albaum, S.& Duerr, E. 2008.)

#### 5.1.1 Export modes

Export modes are considered as the most common primary stage of entering new markets for SME's. A manufacturer chooses the most suitable way of exporting a product considering all risks and advantages.

#### 5.1.2 Non- export entry modes

Non- export strategies comprise of intermediate and hierarchical entry modes.

Intermediate entry modes differ from export modes because they pertain to the movement of knowledge and skills between partners to establish foreign sales. Intermediate strategies do not mean full ownership over a foreign business. A firm can have only shared control with a local partner. This is the main distinguishing factor from hierarchical entry modes. (Hollensen 2011, 356.)

General types of intermediate and hierarchical entry methods are discussed in the next subchapters. Furthermore, their main advantages and disadvantages are reviewed.

### *Intermediate*

Differing from traditional export modes, intermediate entry modes involve a different set of strategies for entering overseas markets. This method is commonly used among firms that have a competitive advantage but cannot enact it themselves in a foreign markets. Inability to transfer production to another country may occur due to high risks or political restrictions. This necessitates companies to reproduce a commodity in a new market with the help of local manufacturers. A firm provides rights to local companies to use its patent, know-how, technical skills and etc. in order to penetrate the new market with its good.

Diverse forms of intermediate entry modes exist. Licensing, franchising, turnkey contracts, joint ventures, contract manufacturing etc. can all be referred to in this category (Czinkota, 442).

### *Hierarchical*

The situation in which a firm fully owns and controls the entry mode is called hierarchical. Hollensen differentiates several types of hierarchical entry modes.

The first and simplest one is a domestic-based sales representative. A company hires a sales representative who travels to a foreign market and conducts sales and consults customers. (Hollensen 2011, 387.) Foreign branch/ sales subsidiary/regional headquarters are another form of establishing a firm in a new market . This occurs when a company launches a branch office. Acquisition is the next hierarchical mode that provides rapid entry to a market through the purchasing or merger with a foreign firm.

This entry strategy allows companies to have complete control over sales, to be closer to their customer and reduce transport costs. Finally, the most arduous and time consuming mode is greenfield investment. A foreign company makes the decision to build a business from a scratch in a foreign market which requires the establishment of plants, open offices and managerial systems. (Hollensen 2011, 387-393.)

When entering a new market a company will assess its strength and weaknesses as well as any potential risks that the business won't be able to cope with. On this basis, the entry strategy chosen will be the one that best suits the company's aims.

## 5.2 Internationalization theories focusing on export

Export plays a significant role in the internationalization of SME's. Five important internationalization theories will be reviewed in order to understand the motivation of companies to enter new markets by exporting.

### 5.2.1 Uppsala model

Swedish researchers from Uppsala University formed an internationalization process model that describes several stages of gradual expansion in a new market. The 'Uppsala internationalization process model' explains how firms approach foreign markets following the same process (Hollensen 2007, 74-75).

The first concept of the model states that companies gain market-specific knowledge before entering a new market. The more knowledge a firm obtains the more involved it will be in a new market. Collecting more knowledge and experience allows companies to spend more resources and eventually benefit from the research. (Johanson and Valhne 1977.)

Johanson and Valhne (1977) made another observation. They examined that companies that were taking steps to internationalize chose markets that were geographically closer to their domestic market. The choice of close physical distance can be explained as companies choosing markets that are of a more familiar environment.

According to the Uppsala model, companies prefer the least risky forms of internationalization (such as export modes) which do not require considerable expenditure of company resources. Figure 5 shows four stages of gradual settling of market.





FIGURE 5. Gradual market entry (Modified from Hollensen 2007, 74.)

In consonance with the figure above, companies chose to enter markets with an export mode through the help of an agent. Gaining more experience in a market and prospering, firms form their local presence by establishing sales subsidiaries. With eventual success as a local presence and then transferring a significant amount of resources, companies can begin manufacturing within their foreign market. (Hollensen 2007, 74-75).

However, the Uppsala model has generated a lot of criticism. Some observations proved that the model is not applicable in certain industries, such as service. Some companies take rapid steps toward internationalization choosing distant markets and more risky entry modes at early stages. That makes the process of entry much quicker which is valuable for fast growing changing markets (Hollensen 2007, 74).

### 5.2.2 Innovation-related Internationalization models

Innovation-related models (I-models) present different stages that a company follows when entering new markets. These stages of internationalization are considered as the innovation process for a firm, as entry into new markets is a challenging process that requires new knowledge and skills (Andersen, 1993). These models represent theories for gradual entry into new markets. Gradual entry is a route taken by companies that are lacking market knowledge and resources to penetrate rapidly.

There are several defined i-models and every model varies in the number of stages it contains. Bilkey and Tesar were the pioneers who proposed the model of six stages in 1977. Cavusgil devised a five stage theory in 1980 and later on Reid (1981) and Czinkota (1982) developed new models in five and six stages. (Andersen, 1993.)

Bilkey & Tesar as well as Czinkota state that firms have no interest in exporting at the first stage while at the second stage companies begin to become interested in exportation. Andersen (1993), emphasizes that the interest to export arose due to an external “push mechanism”, meaning that a company was motivated to export by an agent. Other models tend to treat firms as already interested in export operations in the early stages. (Andersen, 1993.)

Even though there is a wording difference in the models' stages, the process of internationalization is reflected in each model. Researches consider export as the most suitable and least risky mode for incremental entry to a new market.

Innovation-related international modes were criticized for being tautological and moreover, models are not able to explain cases of fast internationalization of companies. (Andersen, 1993.) The table below sums up all the Innovative-related models.

TABLE 2. Innovation-related Internationalization Models. (Modified from Andersen, 1993)

TABLE 2. A review of Innovation-related Internationalization Models. (Andersen, 1993)

	Bilkey & Tesar	Cavusgil	Reid	Czinkota
Stage 1	Management is not interested in exporting	<b>Domestic marketing:</b> The firm sells only to the home markets	Export awareness: Problem of opportunity recognition, arousal of need.	The completely uninterested firm
Stage 2	Management is willing to fill unsolicited order, but makes no effort to explore the feasibility of active exporting	<b>Pre-export stage:</b> The firm searches for information and evaluates the feasibility of undertaking exporting	<b>Export intention:</b> Motivation, attitude, beliefs, and expectancy about export	The partially interested firm
Stage 3	Management actively explores the feasibility of active exporting	<b>Experimental involvement:</b> The firm starts exporting on a limited basis to some psychologically close country	<b>Export trial:</b> Personal experience from limited exporting	The exploring firm
Stage 4	The firm exports on an experimental basis to some psychologically close country	<b>Active involvement:</b> Exporting to more new countries; direct Exporting, increase in sales volume	<b>Export evaluation:</b> Results from engaging in exporting	The experimental firm
Stage 5	The firm is an experienced exporter	<b>Committed involvement:</b> Management constantly makes choices in allocating limited resources between domestic and foreign markets	<b>Export acceptance:</b> Adopting of exporting/ rejection of exporting	The experienced small exporter
Stage 6	Management explores the feasibility of exporting to other more psychologically distant countries			The experienced large exporter

### 5.3 Export as an entry mode

As Albaum & Duerr (2008, 305-391) stated, export modes have three sub-categories: indirect export mode, direct export mode and cooperative export mode.

#### *Indirect export*

Indirect export mode implies a manufacturer giving up responsibilities in carrying out export activities. That is, a domestic company organizes the whole export process. The domestic companies that handle export for producers are regarded as export buying agents, brokers, export management companies or trading companies.

Manufacturers usually benefit from using the service of an experienced export company. This approach suits those manufacturers whose interests are to have less commitment in the processes as well as minimal market and political risks. However, this mode has high risks of damaging the image of a product. Since the producer does not participate in export, he has low control over the marketing mix. The product may face poor service, ineffective channels of distribution or under/overpricing. Moreover, the company has limited information about the foreign market and lacks business contacts (Hollensen 2011, 337-341).

#### *Direct export*

Conversely, the direct export mode involves a producer company to participate in the entire export process. The manufacturer establishes business contacts with intermediaries in a foreign market and handles the documentation, delivery etc. The direct export mode involves foreign distributors, exclusive representatives or agents.

The company then benefits from close business relationships with foreign representatives and potential customers. The firm obtains more knowledge of the local market as well as gaining more experience in selling to a foreign country, while short distribution channels increase revenue. Comparing with the indirect mode, the direct provides more control over the marketing mix. Yet, control over pricing is still insufficient due to tariffs and lack of distribution control. Other disadvantages can emerge from cultural difference. Once entering a foreign market, companies are required to have additional resources to cope with communication problems, trade restrictions and legislation. (Hollensen 2011, 341- 348.)

### *Cooperative export*

The final export mode is cooperative export. This occurs when manufacturers establish collaborative agreements with other firms. Cooperative export is typical in industries such as textiles and furniture or high-technology. The main incentive for such collaboration is the opportunity for 'effective marketing and complementary production program to larger buyers.' (Hollensen 2011, 348- 349.)

The benefit of this particular method is that entry costs and risks are shared between both manufacturers. However this particular union means that firms sacrifice a degree of autonomy and control. Furthermore, the choice of co-operative export carries the risk of an unbalanced relationship between partner manufacturers. (Hollensen 2011, 348- 349.)

#### 5.4 Role of export in economics

Exportation plays a major role in international trade by increasing a country's growth and development. It has been observed that exports grow quicker than GDP in most countries, while an increase in export also helps to bolster GDP as a whole. (Piana,2001.) As soon as the GDP starts to raise, a country starts to experience economic growth. Moreover, export is attractive for investors and increases employment. Due to export activities countries receive a sufficient inflow of currency that helps contribute to import expenses, thus widening the assortment of products in the domestic market.

However, in some cases export can have a negative effect on the economy of a country. When domestic needs are not yet fulfilled by a product and exportation begins, an imbalance in a country's national economy can occur. In this case export can prevent growth of GDP and, as a result, interrupt development of national economic. (Infoplease,2016.)

According to a report from the United Nations (2015), the GDP of most burgeoning markets depend highly on export. Countries in Eastern Europe, parts of Asia and African countries as well as Canada and Mexico are all examples.

On the subject of growth of export as a whole, sufficient growth was observed in both developed and emerging countries. East Asia, Southern Africa and North America reached comparatively bigger increases in export. Competitiveness of export is strongly dependent on the profit or loss made in key export markets. During 2011-2014, a number of Asian countries increased their competitiveness with foreign trade partners. (United Nations, 2015).

## 6 UKRAINIAN WATER TREATMENT MARKET

The Ukrainian market for water treatment is highly competitive. Both domestic and foreign manufacturers have been fulfilling market needs for a number of years, though foreign producers have stronger market positions mostly due to higher quality and more advanced technologies. Lack of publicity of information does not allow an accurate measure of the volumes of the market. Ukrainian industry experts estimate the share of imported products is 60-75% of total market. (Larive International, 2014.)

This chapter will review the Ukrainian water treatment market, based on a study made by a Danish research company as well as an interview conducted by the author of the thesis. Special needs of particular industries will be discussed. Moreover, opinions of Ukrainian distributors interviewed will provide an overall understanding of today's market situation and its potential.

### 6.1 General information

According to a report made by the Ministry of Environmental Protection of Ukraine (2010), Ukraine consumes over 15 billion cubic meters of water per year 40% of which is exploited by industries, 39% by agriculture and the rest 21% for public utilities. The table below shows water consumption by the major industries of Ukraine.

TABLE 3. Water consumption by main industries in millions m<sup>3</sup> in Ukraine (Modified from Larive International, 2014.)

Industry	Water consumption
Energy	3081
Agriculture	2889
Housing and Public Utilities	1856
Metallurgy	1547
Chemical and Petrochemical	140
Food	138
Machinery	77
Coal mining	55
Transport	37
Building materials	24
Oil and Gas	16
Others	226

The main problem facing Ukrainian water consumption are water losses. Approximately 16% of the total pumped water was lost in 2012. More than half of the losses are generated by public utilities due to the poor quality of the piping network as well as outworn technologies. The inefficient usage of water has increased 1.5-2 times more in Ukraine than in developed countries. (Larive International, 2014).

The second and equally as important issue is water pollution, which is a particular problem in the industrial regions of Donetsk, Lugansk, Dnepr, Zaporizhja and Odessa (Larive International, 2014).

The main source of water for Ukraine is the Dnieper river. The large quantity of water used in the dry season decreases the flow of water and causes water deficiency. Apart from water intake, the Dnieper receives a lot of waste water. Lack of wastewater treatment then contaminates the river. (Larive International, 2014.)

All these challenges create demand for more efficient technologies and higher quality equipment in the Ukrainian water treatment market.

## 6.2 Demands for water treatment

### *Demand of public utilities*

The supply of water to individuals is organized by municipally owned companies (vodokanals) that hold a monopoly position. Each vodokanal is responsible for its own region where it supplies local consumers. As it was mentioned above, public utilities struggle with water leaks caused by outdated equipment. Most piping networks have been in use since the Soviet era and 38% of them require replacing. However, only 1.9% were reconstructed due to a lack of financing. (Larive International, 2014.)

Prices for public utilities services are a very sensitive issue for the country which is why most regional vodokanals fail to cover the costs with set tariffs. Poor financing and low water prices for citizens not always appear as a fruitful business for foreign water treatment companies. (Larive International, 2014.)

### *Industrial demand*



The top Ukrainian sectors that consume large amount of water are energy, metallurgy, chemical and pharmaceutical industries, mining, agriculture and food processing. Clean feed water is one of the most important factors in their processes.

## **Energy**

The energy sector is divided into three types: thermal power plants, hydroelectric power plants and nuclear power plants. The largest amount of electricity (90%) is produced by thermal and nuclear power plants. All the nuclear power plants are owned by the government and almost 70% of thermal power plants belong to the private sector. (Larive International, 2014.)

There are two main motivations for Ukrainian energy companies to invest in new water treatment technologies. The first reason is the increasing environmental taxes being applied by the government. The majority of plants use outdated equipment that drastically reduces the production performance and pollutes the environment. High taxes generate a demand for modern equipment for water purification and wastewater treatment. The second reason is the poor quality of water used in the production processes that directly influence the long run of high cost equipment. The safety of facilities also motivates companies to replace their equipment. (Larive International, 2014.)

Larive International conducted an interview among energy industry experts (2014) to reveal the specific demand that are as follows:

- *equipment for profound mechanical filtration*
- *equipment for iron-exchange demineralization*
- *equipment for reverse osmosis (RO) with high level of purification*
- *electro-deionization unit*
- *equipment for water degassing for membranes*
- *equipment for cooling discharged water (heat pumps).*

## **Metallurgy**

Metallurgy is one of the most important industries for Ukraine as it comprises over 40% of its export volume. Also, metallurgy is the largest consumer of water when compared with other industries. As a common issue, the industry has a lot of Soviet equipment in use, consequently, the main challenges faced are the inefficient use of large amounts of water and contamination of wastewater. (Larive International, 2014.)

Fierce competition in the world market of metallurgy drives manufacturers to search for modern technologies to reduce production costs. The needs of metallurgic manufacturers are:

- *profound mechanical purification using sieves and filters, with possible subsequent purification for certain technological processes*
- *demineralization in the RO units*
- *water conditioning for pH-level and low corrosion.* (Larive International, 2014.)

### **Chemical industry**

The Ukrainian chemical industry includes chemical, mining chemical, petrochemical and chemical-pharmaceutical branches. Ukraine takes leading positions in Europe being one of the top-20 chemical producers in the world. Most of this industry is privately-owned. (Larive International, 2014.)

Petrochemical and chemical sectors mainly use closed-circuit water supply systems that consumes enormous amount of water. The processed water contains a number of chemical inclusions and oil products that are necessary to treat before draining water into natural waters. That is why the purification of industrial sewage is the main issue in particular industry. The following needs were identified by Larive International 2014, that are mainly materials:

- *granulated activated*
- *carbonpowered-like activated carbon*
- *polymeric adsorbing materials.*

### **Pharmaceutical industry**

The Pharmaceutical industry is rapidly growing in Ukraine. Annual growth of the market is 17-20% on average. The industry manufactures according to the Good Manufacturing Practices (GMP), that was defined by law to meet EU requirements. Despite the centralization of the water supply, manufacturers use artesian water that is pumped by their own applications of water extraction. Companies are interested in modern systems to transfer already treated and purified water without changing the physical-chemical and microbiological elements. The needs of this industry as determined by Larive International research (2014) were:

- *RO units*

- *De-ionizers of water*
- *Equipment for thermo-distillation*
- *Technologies for the utilization of excessive in-progress heat*
- *Equipment for pumping up of artesian water.*

## **Mining**

The mining industry of Ukraine has significant potential. The country is the 7<sup>th</sup> largest producer of iron ore as well as a significant producer of coal, manganese ore, titanium and zirconium in the world. The government is constantly trying to improve the situation of air and water pollution by issuing state programs and environmental taxes. However, it has so far failed to motivate companies to apply new technologies, as the process of implementation of programs is obscure. (Larive International, 2014.)

## **Agriculture and food**

With its fertile soil, agriculture has always been a strategically important industry for Ukraine. Agro production still remains the number one contributor to the GDP. Even when the growth of GDP remains at zero, agriculture experiences sustainable growth. That is why companies constantly work on increasing the efficiency of their processes, focusing particularly on efficient energy, waste and water consumption. Therefore, there is great potential for water preparation and water treatment facilities. (Larive International, 2014.)

Companies in the food and beverage industries are mainly interested in water purification technologies, as their production should comply with potable water norms, softening, conditioning and sterilization with UV-light. According to the research of Larive International, 2014 the needs for these two industries are as follows:

- *RO units and other membrane systems*
- *Water softeners on the basis of sodium-cation-exchange resins*
- *Automatic coal filters for the dechlorinating and removal of other harmful substances.*

The EU have increased quality requirements after signing the DCFTA agreement, thus increasing the demand for modern technologies supporting water purification and wastewater treatment for agriculture and food production. (Larive International, 2014.)

### 6.3 Interviews with Ukrainian companies

Ukraine is currently going through big changes and the influence that it is having on industry cannot be underestimated. Lack of information in a fast-paced market necessitates conducting interviews with representatives of Ukrainian water treatment companies. Two companies gave their opinions on the current state of the industry, factors that influence it as well as estimated future prospective and the potential for new foreign manufacturers. In order to comply with the rules of anonymity companies were named as 'A' and 'B'.

Company 'A' has operated in the water treatment industry since 1994. Being one of the biggest distributors in Ukraine, the firm works with international manufacturers. Predominantly, 'A' serves in the B2B business, supplying the largest Ukrainian manufacturers.

According to an interview with the sales representative, the water treatment industry in general is experiencing a significant decline in demand due to the economic issues of the country. As for the company in particular, multiple falls in the demand for products can be observed.

The firm named three main factors that are influencing the industry dramatically. The first element is the decline in development of production in the country. It has a direct effect on the industry and as with the decline of production the need for treated water decreases, consequently the demand for water treatment products subsides.

The second factor that influences the company's business is domestic legislation and a lack of reforms in the production sphere. Firm 'A' believes if Ukraine would input the same requirements for clean water standards as in developed countries, it would increase the demand in water treatment industry while protecting the environment significantly.

The military-political situation is another factor impacting the water treatment industry and many businesses as a whole. Undoubtedly, the recent events had a big influence on the economy of Ukraine.

Describing all the negative effects above that industry is experiencing at the moment, company 'A' still believes that there is huge potential for foreign manufacturers. Foreign water treatment manufacturers have a higher quality of production compared to

Ukrainian producers. High quality products with affordable prices will always have a competitive advantage in Ukraine.

Company 'B' is a large Ukrainian distributor of water filters for industrial and residential use. Having representative offices in major cities of Ukraine, the firm offers a wide range of products from foreign manufacturers.

The Marketing Manager of the firm states that 'B' hasn't experienced a decline in demand, moreover, the demand for water treatment has increased. As well as demand, the range of products has increased as well. At the same time, the market is over-filled with cheap low quality products. That is why most of distributors, to escape earning a negative reputation, choose world famous brands who have proved their quality. However, poor brands cause strong price competitiveness by offering lowest prices for their production, thus compelling the water treatment market to decrease its prices drastically.

The 'B' representative highlighted the country's economic situation, financial well-being of the population, currency stability and Customs and Tax law as main factors that have a great impact on the way a business runs.

Company 'B' forecasts stable growth for the water treatment market. Within this market expansion, the number of products and offers will increase. The market players will appear not only as exporters but also local dealers.

Nevertheless, the water treatment market is occupied with a number of foreign manufacturers and the company thinks that there is great potential for new exporters with strong marketing and positioning.

## 7 CONCLUSION AND DISCUSSIONS

The thesis reviews Ukraine as a target market for exporting water treatment products by Bimaks Kimya Ltd. Describing the country's current internal environment, its water treatment industry as well as opinions from Ukrainian companies operating in the industry, we are able to find answers to the main research question.

Despite the limited information on the water treatment industry, the results of the work indicate that Ukraine has a lot of potential for new foreign manufacturers as there is a large demand for high performing goods at competitive prices. However, despite its great potential, the Ukrainian market carries high risks due to an unstable political situation and a poor economic state. Additionally, threats such as tough competition, legislation and bureaucracy may occur during the internationalization process. Therefore limited data as well as the fast-changing Ukrainian environment suggests that exporting would be the most suitable, less risky mode to enter the Ukrainian market.

### **Discussions**

The author found the research very challenging for a number of reasons. Firstly, dealing with the water treatment industry required a specific, often scientific background knowledge, as well as business knowledge. There were also difficulties in finding information about the Ukrainian water treatment industry as there is not a wealth of material on the topic in particular. Moreover, research would be more conclusive if there would be more interviews with representatives of Ukrainian water treatment companies.

However, the author's native language skills were very helpful during the entire research process as it was easier to communicate and search for information in a language that is widely spoken in Ukraine.

All in all, the author positively evaluates the thesis outcomes. All objectives were reflected in the work and the main goal achieved. The author provided all the information that will be necessary for the client company in decision making as well as demonstrating theoretical knowledge acquired during her studies at Savonia. In spite of all the challenges, the author obtained valuable experience during the research process.

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